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No. 06-06-334

IN THE

Supreme Court of the United States

DONALD F. APPOLONI, SR.; RUSSELL C. BERGEMANN; CHARLES BRYCE ENGLE, as personal representative of the estate of Sandra Engle; PHYLLIS F. KLENDER; and ROGER J. PETRI,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether early retirement incentive payments, in exchange for which the plaintiff school teachers surrendered their statutory rights to continued employment under the Michigan Teachers' Tenure Act, constitute "wages" taxable under the Federal Insurance Contributions Act, 26 U.S.C. §§ 3101 *et seq.*

PARTIES

In addition to the parties listed in the caption, William B. Rase was a plaintiff/appellee in *Klender v. United States*.

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DONALD F. APPOLONI, SR.; RUSSELL C. BERGEMANN; CHARLES BRYCE ENGLE, as personal representative of the estate of Sandra Engle; PHYLLIS F. KLENDER; and ROGER J. PETRI,
Petitioners,

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UNITED STATES OF AMERICA,
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On Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

PETITION FOR WRIT OF CERTIORARI

Petitioners Donald F. Appoloni, Sr., Russell C. Bergemann, Charles Bryce Engle, Phyllis F. Klender, and Roger J. Petri respectfully request that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Sixth Circuit in *Appoloni v. United States* and *Klender v. United States*, 450 F.3d 185 (6th Cir. 2006).

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Sixth Circuit is reported at 450 F.3d 185, and is reproduced in the Appendix to this Petititon ("App.") at 1a. The opinion of the United States District Court for the Western District of Michigan in *Appoloni v. United States* is reported at 333 F.

Supp. 2d 624, and is reproduced at App. 61a. The opinion of the United States District Court for the Eastern District of Michigan in *Klender v. United States* is reported at 328 F. Supp. 2d 754, and is reproduced at App. 35a.

JURISDICTION

The judgment of the United States Court of Appeals for the Sixth Circuit was entered on June 7, 2006. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Section 3121 of the Internal Revenue Code, 26 U.S.C. § 3121, provides in pertinent part as follows:

> (a) Wages. For purposes of this chapter, the term "wages" means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include—
>
> . . . .
>
> (b) Employment. For purposes of this chapter, the term "employment" means any service, of whatever nature, performed (A) by an employee for the person employing him, irrespective of the citizenship or residence of either . . . ; except that such term shall not include—
>
> . . . .

STATEMENT

Petitioners seek review of the decision and judgment of the Sixth Circuit, on consolidated appeals from two district court decisions, that the buyout payments the plaintiff school teachers received under their school districts' early retirement incentive programs, in exchange for the teachers' relinquishment of their statutory rights to continued employment under the Michigan Teachers' Tenure Act, constitute "wage" pay-

ments taxable under the Federal Insurance Contributions Act ("FICA"), 26 U.S.C. §§ 3101 *et seq.*

A. Factual Background

Petitioners Donald F. Appoloni, Sr. and Russell C. Bergemann, as well as petitioner Charles Bryce Engle's decedent Sandra Engle,[1] were, until their retirement in June 2001, public school teachers employed by the Dowagiac Union School District in southwestern Michigan. Petitioners Phyllis F. Klender and Roger J. Petri were, until their retirement in June 2000 and June 1997 respectively, public school teachers employed by the Pinconning Area School District in Pinconning, Michigan.

All had been granted "tenure" pursuant to the Michigan Teachers' Tenure Act ("Tenure Act"), Mich. Comp. Laws §§ 38.71 *et seq.* Under that Act, the award of tenure requires a judgment by the school district, based upon the teacher's performance during a probationary period, that the teacher merits a lifetime appointment. *See generally id.*, §§ 38.81-38.91. Thereafter, the teacher is entitled under state law to continued employment with the school district absent "reasonable and just cause," and subject to the procedural protections set forth in the Tenure Act. *See id.*, §§ 38.91-38.105.

All of the teachers accepted buyouts of their tenure rights under early retirement incentive programs offered by their school districts. While differing in some details, these programs provided for the cash payments that are at issue here in exchange for the teachers' relinquishment of their Tenure Act rights to continued employment.

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[1] Following Sandra Engle's death during the pendency of the appeal, her husband and personal representative, petitioner Charles Bryce Engle, was substituted as a party.

The Dowagiac Union School District Plan

During the 2000-2001 school year, the Dowagiac Union School District offered an "employee severance plan" to its most senior teachers. The school district described the purpose of the plan as "to help prevent teacher layoffs and to lessen the [School] Board's economic responsibility in the area of staffing." Under the Dowagiac plan, teachers who (a) had at least ten years' service with the school district, and (b) were at the highest step of the applicable pay scale were eligible to elect to participate in the plan by indicating their intent during a window period. The plan provided that if more than 30 eligible teachers applied, participation would be determined on the basis of seniority, and that if fewer than 15 applied the plan would be cancelled.

Participants in the Dowagiac plan were required to resign from employment with the school district as of June 30, 2001, to "waive . . . all future employment rights, all entitlement to future wage and benefits increases, all rights to participate in any district-sponsored benefit plans," and to "agree not to apply for reemployment" without the school district's consent. In consideration for giving up these rights, participating teachers were to receive the equivalent of their 1999-2000 annual base salary (but no more than $53,021), in 60 monthly payments over a five-year period. Teachers' participation in the plan was entirely voluntary.

Petitioners Appoloni and Bergemann and Sandra Engle opted to participate in the Dowagiac plan. They accordingly signed agreements resigning their employment as of June 2001 and waiving any claim to future employment or employment benefits, including their rights under the Tenure Act. In exchange, Appoloni became entitled to program payments totaling $53,020.80, while Bergemann and Engle each obtained the right to payments of $47,566.80.

The Pinconning Area School District Plans

During the 1996-97 school year and again during the 1999-2000 school year, the Pinconning Area School District offered employee severance incentive programs to teachers with specified years of service with the District.

In 1996-97, Pinconning offered a "Voluntary Teacher Severance Incentive Program," to teachers with ten or more years of service with the school district. Any eligible teacher—*i.e.*, any of the school district's 80 teachers, ranging in age from 34 to 65, who met that eligibility criterion—wishing to participate was required to submit to the school district a signed Severance Agreement. In return, the teacher was to receive a minimum guaranteed payment of $2,000, which would increase to a total of $37,500 if ten or more eligible teachers opted to participate in the program.

Petitioner Petri opted to participate in Pinconning's 1996-97 plan and designated June 30, 1997 as his voluntary retirement date. In the agreement he signed, Petri acknowledged that his acceptance of the school district's buyout offer was entirely voluntary and waived all claims against the school district arising out of his employment and severance from employment. He also "acknowledge[d] that the Program benefit constitutes compensation which the Teacher would not otherwise be entitled to." In exchange, Petri received payments totaling $37,500, which were to be paid in three installments between July 31, 1997 and January 31, 1999.

Several years later, in 1999-2000, Pinconning again offered an early retirement incentive program, this time to teachers with 20 or more years of service. The purpose of the program was to "permit the District to control salary and operating costs." Some 53 teachers, ranging in age from 42 to 63, were eligible to participate. An eligible teacher who agreed to retire as of June 30, 2000 would receive a payment of $46,800, to be made in 72 monthly installments over the

course of six years, while those who opted to participate and retire a year later were to receive payments of $43,200. In consideration for these payments, teachers were required to "waive . . . all future employment rights" and to agree not to apply for reemployment without the school district's consent.

Petitioner Klender accepted the buyout offer and opted for the June 2000 retirement date. She signed papers agreeing that her "employment relationship with the District shall terminate by resignation on June 30, 2000," and that she "waive[d] and release[d] the District forever from rights to re-employment" and from any claims based on her "tenure rights."

FICA Taxes

In making the payments due under these programs, both school districts withheld FICA taxes from the amounts paid to each of the teachers. All of the teachers filed timely claims for refunds of these taxes with the Internal Revenue Service ("IRS"), in which they cited the decision of the Eighth Circuit in *North Dakota State University v. United States*, 255 F.3d 599 (8th Cir. 2001), for the proposition that their program payments were not "wages" on which FICA taxes were due. The IRS denied all of the refund claims, explaining that "[t]he court case you cite, *North Dakota v. U.S.* is currently only being followed in the 8th circuit and is being applied there only to employees who are tenured professors."

B. Proceedings Below

Petitioners Klender and Petri, along with a third plaintiff, filed *Klender v. United States* in the Eastern District of Michigan on March 27, 2002, on behalf of themselves and a class of similarly situated retired teachers, seeking refunds of their FICA taxes. After the presiding judge indicated his belief that a class could not be certified that included taxpayers residing outside that judicial district, *Appoloni v. United States* was filed in the Western District of Michigan

on November 21, 2002 by petitioners Appoloni and Bergemann and Sandra Engle. In both cases, the district courts had jurisdiction over these actions for refund of federal taxes erroneously assessed and collected pursuant to 28 U.S.C. § 1346(a)(1).

The two lawsuits were certified as class actions on behalf of classes encompassing all former employees of Michigan school districts and public postsecondary educational institutions, residing in the Eastern (*Klender*) and Western (*Appoloni*) Districts of Michi an, who received voluntary early retirement incentive program payments from their employers and had unsuccessfully applied to the Internal Revenue Service for refunds of FICA taxes withheld on such payments during the previous two years.

In both cases, the taxpayers and the Government filed cross-motions for summary judgment. In *Appoloni*, Judge Gordon J. Quist entered summary judgment for the Government by order of July 21, 2004. App. 61a. Characterizing the payments in question as "payment[s] arising from services rendered in the past," App. 73a—and relying on a decision of the Court of Federal Claims, *CSX Corp. v. United States*, 52 Fed. Cl. 208 (Ct. Fed. Cl. 2002), rather than the Eighth Circuit's decision in *North Dakota State University, supra, see* App. 70a-72a—Judge Quist held that the payments in question were "wages" under FICA.

Less than two weeks later, in *Klender*, Judge David M. Lawson reached the opposite conclusion, entering summary judgment for the taxpayers by order of August 2, 2004. App. 35a. In contrast to Judge Quist, Judge Lawson concluded that the payments in question were payments for the surrender of a statutory right rather than payments for past services. App. 59a. Following the Eighth Circuit's decision in *North Dakota State University*, Judge Lawson ruled that the payments were not remuneration for employment and therefore not FICA "wages."

Both cases were appealed to the Sixth Circuit and were argued together. On June 7, 2006, the court issued a single opinion deciding both appeals. App. 1a. Reflecting the division of the district courts, the Sixth Circuit panel divided 2-1. In an opinion authored by Senior Judge Kennedy and joined by Judge Cook, the majority affirmed *Appoloni* and reversed *Klender*. In so doing, the majority—on the theory that the tenure rights the teachers relinquished were, "like any other job benefit," earned through their service to the school districts, App. 12a—agreed with the Government that the payments at issue were FICA "wages." In the majority's view, the eligibility requirements for participation in the early retirement programs, including a minimum number of years of service, "indicate the payments were for services performed rather than for the relinquishment of tenure rights." App. 10a. While recognizing that its decision was in conflict with the Eighth Circuit's decision in *North Dakota State University*, the majority found precedential support in—and adopted the reasoning of—the decision of the Court of Federal Claims in the *CSX* case. App. 16a-17a.

In his separate opinion Judge Griffin parted company with the majority on the legal status of the program payments in question as FICA "wages."[2] Judge Griffin described the issue to be decided as "whether the plaintiffs received their . . . remuneration for 'any service' performed by them for their employer," App. 25a, and he concluded that, notwithstanding that plaintiffs' buyout payments arose in the employment setting, these payments "were made in exchange for the relinquishment of plaintiffs' statutory and constitutionally protected tenure rights, rather than as remuneration for services

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[2] Judge Griffin concurred with the majority with respect to plaintiff William B. Rase (who is not a petitioner in this Court), on the ground that Rase had failed to produce sufficient evidence that the payment he received was contingent upon his relinquishment of his tenure right. App. 23a.

to the school districts." App. 28a. In this regard Judge Griffin rejected the "majority's rationale that the ESP payments were made in consideration of the plaintiffs' past years of service" on the ground that it was "belied by the fact that similarly situated employees who did not relinquish their tenure rights received nothing," App. 31a, as well as the fact that the payments were related neither to the plaintiffs' loss of actual wages nor to their loss of future earning capacity. App. 30a. Thus, and on the strength of the Eighth Circuit's decision in *North Dakota State University*, which involved "a materially indistinguishable set of facts," App. 31a—as well as a later, equally "indistinguishable," district court decision in *University of Pittsburgh v. United States*, No. 04-1616, 2005 WL 3619245 (W.D. Pa. Oct. 18, 2005), *appeal pending*, No. 06-1276 (3d Cir.), *see* App. 32a—Judge Griffin would have held that such payments "do not constitute 'wages' for purposes of FICA." App. 34a.

REASONS FOR GRANTING THE WRIT

It is a common practice for public educational institution employers who are confronted with uncertain revenue or declining employment needs to institute voluntary early retirement incentive programs, pursuant to which the employer agrees to make payments of a specified sum to senior teachers in exchange for the teachers' relinquishment of their tenure rights to continued employment. And, in a variation on the same theme, it is an increasingly common practice for private sector employers who are confronted with similar economic imperatives and who are parties to collective bargaining agreements (or other legal restraints on at-will employment) to offer their employees buyout payments in exchange for the relinquishment of such contractual (or other) rights to continued employment.

The question presented here is whether such payments made pursuant to an employer's retirement incentive program

constitute "wages" taxable under the Federal Insurance Contributions Act, 26 U.S.C. §§ 3101 *et. seq.* While the Government answers that question in the affirmative, petitioners contend that the FICA statute, read in accord with general principles of statutory interpretation and this Court's FICA jurisprudence, requires the answer that such payments made in exchange for the employee's relinquishment of a legally enforceable right to continued employment—whether grounded in statute or contract—are not "wages" within the meaning of FICA.

This legal question has spawned recurring litigation, particularly with regard to payments by public educational institution employers to tenured educators in exchange for the educators' agreement to surrender their tenure rights.

That litigation has led first of all to differing decisions in the district courts and now to a sharp conflict in the circuits between the Eighth Circuit's decision in *North Dakota State University*, and the Sixth Circuit's decision in the instant case. As the court below "recognize[d, its] holding . . . differs from what the Eighth Circuit held in *North Dakota*." App. 16a. Given the nature and importance of the recurring legal question decided one way by the Eight Circuit in *North Dakota State University* and the opposite way by the Sixth Circuit in the instant case, this Court should grant certiorari to resolve this conflict in the circuits. That is particularly so because, we submit, the Sixth Circuit's reasoning and its ultimate conclusion that by "disagree[ing] with the holding in *North Dakota*" and "agree[ing] with the [contrary] reasoning" of the *CSX* decision it had "reached the correct result," App. 16a-17a, are legally unsound.

I.

The Eighth Circuit in *North Dakota State University* and the Sixth Circuit in this case are squarely in conflict on the correct answer to the legal question both cases present.

A. The *North Dakota State University* case involved an Early Retirement Program under which senior tenured faculty members were offered the opportunity to negotiate a payment (capped at 100% of the employee's most recent annual salary), in exchange for which "the employee agreed to give up any tenure, contract, and/or other employment rights, agreed not to seek employment with a North Dakota public university or college, and agreed to give up any claim against NDSU under the Age Discrimination in Employment Act." 255 F.3d at 601. The tenure rights relinquished under this program gave the teachers the assurance that "[a]bsent fiscal constraints or adequate cause, a tenured faculty member could not be terminated." *Id.*

Against that background, as the Eighth Circuit put it, "[t]he crux of this case is whether payments made to tenured faculty, in exchange for which the tenured faculty gave up their tenure rights, are subject to FICA taxes as defined by the Internal Revenue Code." *Id.* at 603. And, as to that "crux of [the] case," the Eighth Circuit concluded:

> Under the terms of the Early Retirement Program, the tenured faculty received a negotiated amount of money in exchange for giving up their constitutional and contractual rights to tenure. In other words, they relinquished their tenure rights. . . . We hold that payments made to tenured faculty under NDSU's Early Retirement Program were made in exchange for the relinquishment of their contractual and constitutionally-protected tenure rights rather than as remuneration for services to NDSU. Thus, the payments are not subject to FICA taxation.

Id. at 607.

In essence the Eighth Circuit reasoned to that holding as follows. First, the court set out the statutory framework in the following terms:

> The Internal Revenue Code imposes FICA taxes on "wages" received by an employee "with respect to

> employment." Internal Revenue Code (I.R.C.) § 3101, 26 U.S.C. § 3101. . . .
>
> Although wages and employment are read broadly in the FICA context, clearly not all payments by employers to employees constitute wages. . . . The payments must be remuneration for services provided by the employee to his employer to be subject to FICA taxes.

Id. at 603.

Next, the Eighth Circuit abstracted "[t]hree closely related principles . . . from our review of the tax law [*i.e.*, IRS revenue rulings and court decisions] relevant to this dispute." *Id.* First, "payments to relinquish rights under a contract are not wages for FICA purposes." *Id.* at 604. Second, "payments made pursuant to an employment contract are wages for FICA purposes." *Id.* And finally, "payments for past services, or seniority rights, are wages for FICA purposes." *Id.* The court then determined that the first of these—that "payments to relinquish rights [to future employment] under a contract are not wages for FICA purposes"—was the governing principle with regard to the voluntary early retirement incentive program payments at issue, in exchange for which the faculty members surrendered their tenure rights. *Id.* at 607. That was because the tenured faculty members "did not receive what they were entitled to under their contracts, which was continued employment absent fiscal constraints or adequate cause for termination. Rather they gave up those rights . . . ." *Id.*

The Eighth Circuit's decision in *North Dakota State University* thus rests exactly on the principle that where an employee enjoys a legally enforceable right to continued employment, a buyout payment in exchange for which the employee voluntarily surrenders that right does not constitute wages subject to FICA taxation.

B. In the instant case the Sixth Circuit broke with the Eighth Circuit, not only in result but in reasoning, by holding that the school districts' payments to tenured teachers in exchange for the teachers' relinquishment of their tenure rights were "wage" payments under FICA. As the Sixth Circuit explained—in "recogniz[ing that its] holding . . . differs from what the Eighth Circuit held in *North Dakota*," App. 16a—the holding below rests on two legal propositions.

First, as a general matter, the Sixth Circuit based its analysis on the view—adopted from the opinion of the Court of Federal Claims in the *CSX* case—that

> [R]ights to vacation pay, sick pay, layoff pay, *and seniority*—constituted part of the employee's total compensation package and, hence, constituted wages. Therefore, when these job-related benefits are relinquished in favor of a lump-sum payment, the transaction simply amounts to a redemption, paid in cash, of wage amounts previously paid in kind. Because a separation payment is simply an exchange of equivalent values, what were wages at the start remain wages at the end.

App. 16a-17a (quoting 52 Fed. Cl. at 221) (emphasis added by Sixth Circuit). And, the Sixth Circuit asserted, there was "no reason to differentiate tenure rights from any other right an employee earns through service to any employer." App. 17a. Thus, just as "the relinquishment of seniority rights . . . in exchange for a severance payment constitute[s] FICA wages," *id.*, so does the relinquishment of tenure rights in exchange for an early retirement incentive program payment.

Second, the Sixth Circuit emphasized that the "principal purpose" of the school districts' payments "was not to 'buy' tenure rights" but rather "to induce [the tenured teachers] at the highest pay scales to voluntarily retire early." App. 14a. As such, those payments "were essentially severance payments" subject to the general rule "that severance payments for the relinquishment of rights in the course of an employ-

ment relationship are FICA wages." App. 12a-13a. That general rule applied here, the Sixth Circuit believed, because there was "no reason to differentiate the relinquishment of tenure rights from the relinquishment of other benefits earned during the course of employment, like the right to bring suit, or rights associated with seniority." App. 14a.

In short, the Sixth Circuit did not "differ[] from what the Eighth Circuit held in *North Dakota*," App. 16a, in some narrow regard. Rather, the Sixth Circuit's holding, and the legal reasoning on which that holding is based, are directly contrary to the Eighth Circuit's holding and reasoning in *North Dakota State University*.[3]

II.

It is the Eighth Circuit, we submit, that has correctly decided the question of statutory interpretation that is presented by these cases.

A. Analysis begins, of course, with the statutory language. FICA imposes a tax on "wages" received by any individual, 26 U.S.C. § 3101(a), (b), and a parallel tax on

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[3] The *North Dakota* appeal was, as Judge Griffin emphasized in his dissent, decided on "a materially indistinguishable set of facts" from those of the instant case. App. 31a. To be sure, there may be factual differences as to how tenure is acquired in the school and university settings, as the Sixth Circuit majority observed, App. 16a n.5—even though in both cases the basis for the award of tenure is the employer's judgment that the teacher merits a lifetime appointment. Any distinctions in how tenure is awarded in the school and university settings are largely immaterial to the legal issue presented here. What is relevant is not how tenure is acquired, but rather the legal entitlement it gives the tenured teacher—the legally enforceable right to continued employment. *That* is what is relevant here because that is what the teachers gave up in exchange for the buyout payments that are at issue. In that regard, there is no significant difference between the legal rights that were surrendered in exchange for buyout payments by the university professors in *North Dakota* and the plaintiffs in this case.

"wages" paid by the employer, 26 U.S.C. § 3111(a), (b). The term "wages" is specifically defined in the statute to mean (with certain exceptions not relevant here) "all remuneration for employment." 26 U.S.C. § 3121(a). "Employment" is, in turn, defined (again with exceptions not applicable here) as "any service, of whatever nature, performed . . . by an employee for the person employing him." 26 U.S.C. § 3121(b).

Whether the payments at issue here were FICA "wage" payments thus depends on whether those payments were "remuneration" for "service . . . performed . . . by [the] employee for the person employing him." And, while this statutory language is to be read expansively, an employer's payment of a sum of money to an employee in exchange for the employee's agreement to surrender a legally enforceable right to continued employment cannot, consistent with any fair regard for the statutory words, be characterized as remuneration for a service performed by the employee for his or her employer. The district judge in the *Klender* case went to the heart of the statutory interpretation matter when he stated:

> [T]he payments in this case were not for services, past, present or future. Rather, they were made in exchange for the employees' relinquishment of the right to exchange services for wages in the future. They were not payments for work; they were payments not to work.

App. 54a.

Thus, while there is no doubt that the plaintiffs had performed "service" for their school district employers, it is equally clear that the payments in question were *not* made in exchange for that service. In our view, the statutory language compels the conclusion that when an employer pays its employee a sum of money in exchange for the employee's agreement to surrender a legally enforceable right to continued employment—whether the right thus relinquished is derived from statutory provisions (as in this case) or from a contractual agreement—the employer's payment cannot fairly

be described as consideration for the employee's service previously rendered to the employer and thus does not constitute "wages" for purposes of FICA taxation.[4]

In reaching the opposite conclusion, the Sixth Circuit majority reasoned that "the eligibility requirements for qualifying for a payment—that a teacher served a minimum number of years—indicate the payments were for services performed rather than for the relinquishment of tenure rights." App. 10a. That view, we respectfully submit, confuses *eligibility to participate* in the buyout program with *eligibility to receive a payment* under the program. While 10 or 20 years' prior service qualified an employee to opt for participation in a buyout plan, such service in itself did not entitle the employee to any payment. That the buyout payments were not earned by, or intended to compensate for, plaintiffs' prior service to their school districts is—as Judge Griffin observed, App. 29a-30a—apparent from the fact that similarly situated colleagues who chose not to accept the buyout offer did not receive any payment. That fact makes clear that the payments were not some additional consideration for plaintiffs' prior years of service, for which they already had been fully compensated, but rather were consideration for plaintiffs' agreement to do something else—to give up their legally enforceable rights to continued employment in the future.[5]

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[4] Nor can the teachers' tenure rights fairly be characterized as something they earned as part of the compensation for their employment. Tenure in Michigan is not a benefit conferred on teachers by their employers, but is, to the contrary, a statutory limitation on the freedom of contract imposed by the state on its political subdivisions that employ teachers, in order to further certain public policy goals established by the legislature. *See* Mich. Comp. Laws §§ 38.91-38.105; *Wilson v. Flint Bd. of Educ.*, 106 N.W.2d 136, 137 (Mich. 1960).

[5] Cases involving severance payments to at-will employees, such as those on which the Sixth Circuit relied, App. 13a (citing *Abrahamsen v.*

B. This Court's decisions construing the relevant statutory language are entirely consistent with that conclusion.

Social Security Board v. Nierotko, 327 U.S. 358 (1946), holds that a make-whole award intended to compensate an employee for wages he would have earned by performing services for the employer—which he stood ready to perform but for the employer's unlawful act—are "wages" for purposes of FICA taxation, notwithstanding that the employee was prevented by the employer from performing actual "service" in exchange for the payment.

Nierotko involved backpay awarded to an employee determined to have been discharged for union activity in violation of the National Labor Relations Act ("NLRA"). In rejecting the Social Security Board's position that the backpay award was not "wages" for purposes of calculating the employee's social security benefits, this Court emphasized the employee's entitlement under the NLRA to be made whole for the employer's wrong:

> [R]eparation to the employee through "back pay" . . . is based upon the loss of wages which the employee has suffered from the employer's wrong. "Back pay" is not a fine or penalty imposed upon the employer by the [National Labor Relations] Board. Reinstatement and "back pay" are for the "protection of the employees and the redress of their grievances" to make them "whole."

Id. at 364-65 (quoting *Republic Steel Corp. v. NLRB*, 311 U.S. 7, 11, 12 (1940)). And, the Court was not persuaded by

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United States, 228 F.3d 1360 (Fed. Cir. 2000); *Associated Electric Cooperative, Inc. v. United States*, 226 F.3d 1322 (Fed. Cir. 2000)), are readily distinguishable inasmuch as such payments are not in exchange for the surrender of any legally enforceable right to continued employment. For example, the payments in *Associated Electric* were "[p]ayments for hard work and faithful service" that the employer made because it "was the right thing to do." 226 F.3d at 1327.

the Social Security Board's contention that the employee had not in fact performed any "service" in exchange for the backpay award:

> The very words "any service . . . performed . . . for his employer," with the purpose of the Social Security Act in mind, import breadth of coverage. They admonish us against holding that "service" can be only productive activity. We think that "service" as used by Congress in this definitive phrase means not only work actually done but the entire employer-employee relationship for which compensation is paid to the employee by the employer.

327 U.S. at 365-66.

Nierotko thus establishes that an employer's payment tied to the performance of services for the employer *can* constitute "wages" where the employer prevents the employee from actually performing the service. But *Nierotko* cannot be read as establishing a blanket rule that *all* payments arising out of the employer-employee relationship are wages. To the contrary, such a reading is foreclosed by this Court's subsequent decisions in *Central Illinois Public Service Co. v. United States*, 435 U.S. 21 (1978), and *Rowan Cos. v. United States*, 452 U.S. 247 (1981), which, taken together, establish that certain payments arising out of the employment relationship are *not* wages.

Central Illinois held that an employer's payments reimbursing its traveling employees for their lunch expenses were not wages. In reaching that result, the Court specifically rejected the Government's "rather facile conclusion" that "the mere fact that the reimbursements were made in the context of the employer-employee relationship" governed the outcome. 435 U.S. at 29. While *Central Illinois* construed the term "wages" for purposes of income-tax withholding under § 3401(a) of the Internal Revenue Code, 26 U.S.C. § 3401(a), the Court held three years later—in striking down Treasury Department regulations that counted the value of employer-

provided meals and lodging as "wages" under FICA—that the term "wages" had the same meaning under § 3401(a) as it did for purposes of FICA taxation under § 3121(a). *Rowan, supra*.[6]

In short, while *Nierotko* treats make-whole payments as wages even without the performance of actual service, there is no basis either in this Court's cases, in the statutory language, or otherwise in reason and logic, for extending that holding beyond the context of make-whole awards to encompass the buyout payments at issue here—which were not intended to make the teachers whole for lost employment but instead were made in order to induce them to surrender a legally enforceable right.

C. The IRS made an attempt to settle the issue presented here—in its favor—while this litigation was pending on appeal. In December 2004 the IRS issued Revenue Ruling 2004-110, 2004-50 I.R.B. 960, which abrogated and modified previous revenue rulings of long standing. The Sixth Circuit did not rely on that revenue ruling, in part because the IRS had stated its intention to apply it only prospectively. *See* App. 15a n.4. But it is equally clear that the recent revenue ruling cannot be taken, even prospectively, as settling the

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[6] Subsequently, in 1983, Congress amended § 3121(a) to permit the Treasury Department to enact regulations that treat the term "wages" differently for FICA and income-tax withholding purposes. *See* 26 U.S.C. § 3121(a) (last paragraph) (enacted by Pub. L. No. 98-21, 97 Stat. 65, 127 (1983)). That amendment has no bearing on *Rowan*'s validity in the absence of such regulations. *See CSX Corp.*, 52 Fed. Cl. at 213; *Anderson v. United States*, 929 F.2d 648, 653 n.10 (Fed. Cir. 1991). Nor, *a fortiori*, does it call into question *Rowan*'s application to § 3121 of the general principle established by *Central Illinois* that not all payments arising out of the employer-employee relationship necessarily are wages.

issue, for the ruling is entitled to no deference under the doctrine of *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944).[7]

Revenue Ruling 2004-110 superseded Revenue Ruling 58-301, 1958-1 C.B. 23, in which the IRS had held that a payment made to an employee to buy out several years remaining on his employment contract did not constitute "wages." It also modified—"to the extent their holdings regarding FICA [and related statutes] rely on distinguishing Rev. Rul. 58-301" —two other rulings, including Revenue Ruling 75-44, 1975-1 C.B. 15, in which the IRS had determined that a payment to an employee in exchange for his agreement to waive his seniority right and accept a transfer to another job was "wages." In their place, Revenue Ruling 2004-110 adopted an all but boundless definition of "employment" for purposes of judging whether a payment is "remuneration for employment":

> Employment encompasses the establishment, maintenance, furtherance, alteration, *or cancellation* of the employer-employee relationship or any of the terms and conditions thereof.

Rev. Rul. 2004-110, 2004-50 I.R.B. 960, 961 (emphasis added). The IRS added that an employer's payment would not be "wages" if—and apparently *only* if—"the employee provides clear, separate, and adequate consideration for the employer's payment *that is not dependent upon the employer-employee relationship* and its component terms and conditions." *Id.* (emphasis added).

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[7] Revenue rulings, while intended by the IRS as internal precedents to be applied in other cases, *see* Rev. Proc. 89-14, 1989-1 C.B. 815, are not issued pursuant to the Treasury Department's rulemaking authority, and are not entitled to the deference courts accord to agency rules under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). *See generally United States v. Mead Corp.*, 533 U.S. 218 (2001); *Aeroquip-Vickers, Inc. v. Commissioner*, 347 F.3d 173, 180-81 (6th Cir. 2003) (applying *Mead* to IRS revenue rulings).

Under the *Skidmore* standard, Revenue Ruling 2004-110 cannot be taken as settling the issue presented here. The ruling is inconsistent with the IRS' own ruling of nearly 50 years' standing in Revenue Ruling 58-301, and the IRS explained its decision to change course only with the conclusory assertion that the earlier ruling had "erred in [its] analysis by failing to apply the Code and regulations appropriately to the question of whether the payments made in cancellation of the employment contract were wages." *Id.* Equally to the point, the definition of "employment" upon which Revenue Ruling 2004-110 is based both strays impossibly far from the statutory definition of employment as "service . . . performed" for an employer, 26 U.S.C. § 3121(b), and cannot conceivably be reconciled with this Court's decision in *Central Illinois*, which rejected the Government's "rather facile conclusion" that "wages" encompassed any payment that was "a result of the employment relationship." 435 U.S. at 29.[8]

III.

The question presented is an important one that requires the authoritative answer only this Court can afford.

Voluntary early retirement incentive program payments by employers to employees in exchange for the employee's relinquishment of his or her legally enforceable right to continued employment are exceedingly commonplace. That is true particularly, but by no means exclusively, in the contexts of public school districts and of institutions of higher edu-

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[8] The lunch reimbursements for traveling employees that the *Central Illinois* Court held were not wages would have to be treated as wages under the standard enunciated by Revenue Ruling 2004-110, which counts all employer payments as wages unless there is "clear, separate, and adequate consideration for the employer's payment that is not dependent upon the employer-employee relationship and its component terms and conditions."

cation. For example, petitioners estimate that—although published data are not available—approximately 300 early retirement incentive plans similar to those at issue in this case were adopted during the last five years by public school districts in Michigan alone.

Nor are such buyout programs limited to the education context. To the contrary, while "tenure" is a creature of educational employment, employees in many contexts have legally enforceable rights to continued employment—whether for life or for a time certain—that may be subject to a buyout offer from the employer that would raise the same issue that is presented here. Such legal rights could derive from an individual employment contract, a collective bargaining agreement, or (as is often the case in public employment) statutory provisions. The arguments raised here—on both sides of the issue—are equally applicable to payments through which the employer buys out that legal right.

For example, in *CSX Corp.*, the Court of Federal Claims held that a railroad's payments buying out its employees' contractual rights to continued employment were wages, thus declining to follow the Eighth Circuit's decision in *North Dakota*. The court did so on the basis of its disagreement with the Eighth Circuit—not because of any material difference in the facts of the two cases. To the contrary, the court emphasized that it

> can see no basis upon which to distinguish between the tenure rights considered in *North Dakota* and the contract rights at issue here. In each case, the surrender of these rights in return for a cash payment represents the surrender of enforceable rights to future earnings in return for a present sum.

52 Fed. Cl. at 221.

Buyout offers are common in many industries with shrinking employment, and employees in these industries—like the rail-

road employees in *CSX*—frequently have a legally enforceable right to continued employment under a collective bargaining agreement, which the employer will often offer to buy out if it wishes to reduce its workforce. For example, both General Motors Corporation and Ford Motor Company have announced in recent months offers to buy out the continued employment rights of tens of thousands of their unionized employees. *See Ford Expects Up to 11,000 Workers to Accept Buyouts*, Fox News.com, June 19, 2006; *40,000 Said to Accept GM, Delphi Buyouts*, CNNMoney.com, June 23, 2006 (reporting that 30,000 GM and 10,000 Delphi unionized employees had accepted buyouts). In short, the issue presented by this case extends far beyond the school and university settings in which many of the cases litigated to date have arisen.[9]

So long as the Government hews to its current position and decisions such as the Sixth Circuit's in the instant case and that of the Court of Federal Claims in the *CSX* case are on the books, employers will almost certainly treat such payments as FICA wage payments and withhold accordingly. And, so long as decisions such as the Eight Circuit's in *North Dakota State University* and the district court's in *University of Pittsburgh* are on the books, the employers or affected employees who are not within the Sixth Circuit will bring actions seeking refund of the withheld taxes. Given the

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[9] It also bears noting that many of the cases that have arisen in this area or are likely to do so involve substantial amounts of money. While the instant cases were brought as class actions on behalf of individual employees, much of the litigation in this area is brought by employers—who pay half of the FICA taxes (and are required to withhold their employees' halves). Particularly for a larger employer, the sums that are—or are not—payable in FICA taxes as a result of a buyout of continued employment rights can be considerable. For example, the General Motors program referenced above offers buyouts ranging in value from $70,000 to $140,000. *See* CNNMoney.com, *supra*. Assuming $100,000 as the average value of the buyouts accepted by some 30,000 employees, the 7.65% employer's share of FICA taxes payable on the buyouts would total nearly $230 million.

number of such programs and the large amount of taxes that are involved, that is a wholly unacceptable state of affairs.

The courts of appeals have frequently had occasion to emphasize the particular importance of uniformity of decisions among the circuits in federal tax law.[10] Given the substantial amounts of money that can be at stake in FICA taxes on buyout payments, the frequency with which such buyouts take place, and the inability of the lower federal courts to agree on the analysis of these cases, it is incumbent upon this Court to resolve the uncertainty that presently exists in the law as to whether such buyouts constitute "wages" on which FICA taxes are due.

CONCLUSION

The Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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September 5, 2006

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[10] *See, e.g., Copeland v. Commissioner*, 290 F.3d 326, 336 (5th Cir. 2002); *Aeroquip-Vickers, Inc. v. Commissioner*, 347 F.3d 173, 181 (6th Cir. 2003); *330 West Hubbard Rest. Corp. v. United States*, 203 F.3d 990, 994 (7th Cir. 2000); *North Am. Life & Cas. Co. v. Commissioner*, 533 F.2d 1046, 1051 (8th Cir. 1976); *Hill v. Commissioner*, 204 F.3d 1214, 1217-18 (9th Cir. 2000); *Grimland v. United States*, 206 F.2d 599, 601 (10th Cir. 1953); *Washington Energy Co. v. United States*, 94 F.3d 1557, 1561-62 (Fed. Cir. 1996).

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

Nos. 04-2068; 05-1049

No. 04-2068

DONALD F. APPOLONI, SR., RUSSELL C. BERGEMANN,
and CHARLES BRYCE ENGLE,
Plaintiffs-Appellants,

v.

UNITED STATES OF AMERICA,
Defendant-Appellee.

No. 05-1049

PHYLLIS F. KLENDER, WILLIAM B. RASE,
and ROGER J. PETRI,
Plaintiffs-Appellees,

v.

UNITED STATES OF AMERICA,
Defendant-Appellant.

Appeal from the United States District Courts
for the Western District of Michigan at Lansing
and the Eastern District of Michigan at Bay City.
Nos. 02-00176; 02-10082-Gordon J. Quist and
David M. Lawson, District Judges.

Argued: January 27, 2006

Decided and Filed: June 7, 2006

Before: KENNEDY, COOK, and GRIFFIN, *Circuit Judges.*

OPINION

KENNEDY, Circuit Judge. In these cases consolidated on appeal, we address whether payments made to public school teachers, who relinquished their statutory tenure rights and resigned from their positions upon accepting the payments, constitute "wages" taxable under the Federal Insurance Contribution Act ("FICA"). *Appoloni v. United States* was filed in the United States District Court for the Western District of Michigan; *Klender v. United States* was filed in the United States District Court for the Eastern District of Michigan. In each case, both parties filed cross-motions for summary judgment. In *Appoloni,* the district court granted summary judgment for the government; in *Klender,* the court granted summary judgment for the Plaintiffs. For the following reasons, we hold that the payments made in exchange for the relinquishment of statutorily granted tenure rights constitute "wages" taxable under FICA. Thus, we REVERSE the district court's judgment in *Klender,* and we AFFIRM the court's judgment in *Appoloni.*

BACKGROUND

On March 27, 2002, three taxpayers filed suit in the Eastern District of Michigan. On November 21, 2002, three taxpayers brought suit in the Western District of Michigan. Both lawsuits were certified as class actions and differ only in minor respects not relevant here. In general, the class encompasses all former employees of Michigan school districts and public post-secondary education institutions, residing in the Eastern *(Klender)* and Western *(Appoloni)* Districts of Michigan who received early retirement incentive payments from their respective school districts and who unsuccessfully applied to the Internal Revenue Service ("IRS") for refunds of FICA taxes withheld from those payments.

I. *Appoloni*

Plaintiffs, Donald Appoloni, William Bergemann, and Sandra Engle, were tenured public school teachers employed by the Dowagiac Union Public School District (the "School District"). All three had been granted tenure by the School District pursuant to the Michigan Teachers' Act ("Tenure Act") Mich. Comp. Laws § 38.71. In Michigan, a teacher automatically earns tenure by successfully completing a probationary period. *See* Mich. Comp. Laws § 38.71. As tenured teachers, Plaintiffs were entitled to continued employment with their respective school districts absent "reasonable and just cause" and subject to the procedural protections set forth in the Tenure Act.

During the 2000-2001 school year, the School District offered an early "employee severance plan" ("ESP") to its most senior teachers. Teachers who had at least ten years of service with the School District and were at a high step in the pay scale, were eligible to participate in the plan. Participation in the plan was voluntary, and the plan provided that if more than 30 eligible teachers applied, eligbililty to participate would be determined on the basis of seniority. The purpose of this plan was to "help prevent teacher layoffs and to lessen the Board's economic responsibility in the area of staffing." J.A. at 77.

Participants in the ESP were required to resign as of June 30, 2001, and to agree to a waiver providing that the teacher "waived all claims arising out of employment with the District, including claims . . . under the Tenure Act." Additionally, participating teachers agreed to "waive . . . all entitlement to future wage and benefit increases, all rights to participate in any district sponsored benefit plans" and agreed to not "apply for reemployment" without the School District's consent. J.A. at 81. Participating teachers received the equivalent of their 1999-2000 annual base salary (but not more than

$53,021) in 60 monthly payments over a five-year period. J.A. at 25.

The School District withheld FICA taxes from the installment payments. Relying on the Eighth Circuit's decision in *North Dakota State Univ. v. United States,* 255 F.3d 599 (8th Cir. 2001), the taxpayers filed claims for refunds of the FICA taxes withheld, and when the IRS denied those claims, the taxpayers filed suit in the Western District of Michigan.

Both the Plaintiffs and the government filed motions for summary judgment. The district court granted the government's motion and denied the Plaintiffs' motion. Plaintiffs filed this timely appeal.

II. *Klender*

The *Klender* litigation similarly involves tenured teachers who were offered an "Employee Severance Plan" designed to induce tenured teachers to retire. In *Klender*, all three Plaintiffs—Phyllis F. Klender, Roger J. Petri, William B. Rase—were employed as Michigan public school teachers and also had been granted tenure pursuant to the Tenure Act.

Plaintiff Klender accepted a buyout that the Pinconning Area School District offered her during the 1999-2000 school year. The buyout was offered to teachers with 20 or more years of service with the district. Any eligible teacher who agreed to retire as of June 30, 2000, would receive a payment of $46,800 made in 72 monthly installments over six years. In exchange, teachers were required to "waive . . . all future employment rights," to agree not to apply for re-employment in the district without the district's consent, and to "waive and release the District forever from rights to re-employment and from any claims based, inter alia, on her 'tenure rights.'" J.A. at 47.

Plaintiff Petri accepted a "Voluntary Teacher Severance Incentive Program" offered by the Pinconning Area School District to teachers with ten or more years of service. If an

eligible teacher agreed to "voluntarily resign his or her employment with Pinconning Area Schools [and] forfeit all seniority rights," the teacher would receive a minimum guaranteed payment of $2,000. That payment increased to a total of $37,500 if ten or more eligible teachers opted to participate in the program. Plaintiff Petri accepted the buyout offer on February 17, 1997.

Plaintiff Rase also accepted a buyout that was offered pursuant to an "early retirement" provision in a collective bargaining agreement between the West Branch-Rose City Area School District and the West Branch-Rose City Education Association. Teachers with a minimum of 20 years' service in the District and 25-29 years' credit under the Michigan Public School Employees' Retirement Plan qualified for an early retirement incentive. Incentive payments began at $30,00 [sic] for teachers with 25 years and decreased by $5,000 for each additional year of retirement credits up to 29. On January 24, 2001, Plaintiff Rase announced his retirement.

In making these buyout payments to Plaintiffs Klender, Petri, and Rase, the school districts withheld FICA taxes from the amount paid. Between August and October of 2001, all three Plaintiffs filed claims for refunds with the IRS. The IRS denied the claims. Plaintiffs then filed this action in the Eastern District of Michigan. Both parties filed cross motions for summary judgment. The district court denied the government's motion and granted the Plaintiffs'. This appeal followed.

STANDARD OF REVIEW

We review a district court's grant of a motion for summary judgment *de novo*. *Wojcik v. City of Romulus*, 257 F.3d 600, 608 (6th Cir. 2001). Summary judgment is appropriate "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact." Fed. R. Civ.

P. 56(c). "There is no such issue unless there is sufficient evidence favoring the nonmoving party for a jury to return a verdict for that parry. . . . [T]he inquiry is whether the evidence presents a sufficient disagreement to require submission to a jury or whether it is so one-sided that one party must prevail as a matter of law." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 243 (1986). "The fact that the parties have filed cross-motions for summary judgment does not mean, of course, that summary judgment for one side or the other is necessarily appropriate." *Parks v. LaFace Records*, 329 F.3d 437, 444 (6th Cir. 2003). "When reviewing cross-motions for summary judgment, we must evaluate each motion on its own merits and view all facts and inferences in the light most favorable to the nonmoving party." *Westfield Ins. Co. v. Tech Dry, Inc.*, 336 F.3d 503, 506 (6th Cir. 2003).

ANALYSIS

This case presents an issue of first impression in this circuit: are payments made by school districts to public school teachers in exchange for the relinquishment of those teachers' statutorily granted tenure rights considered "wages" taxable under FICA?

FICA, codified in Chapter 21 of the Internal Revenue Code, Sections 3101 through 3128, imposes a tax upon the wages of employees to fund Social Security and Medicare Benefits. This tax is collected by the employer by deducting the tax from wages at the time of payment. Section 3111 imposes a matching tax on the employer with respect to wages paid to the employee.

Plaintiffs argue that the payments in this case should not be considered "wages" for purposes of FICA, and therefore, FICA taxes were wrongly withheld from those payments. Plaintiffs rely on an Eighth Circuit decision, *North Dakota State Univ. v. United States*, 255 F.3d 599 (8th Cir. 2001), for this proposition. In *North Dakota*, payments were made to

tenured university professors pursuant to an early retirement program. That court held that those payments were not "wages" for FICA purposes.

The government argues that *North Dakota* is distinguishable and that the payments at issue in this case easily fit within the statutory definition of "wages," and thus, the taxes were properly withheld.

I.

We begin by examining the definition of "wages" for purposes of FICA. Section 3121(a) of the Internal Revenue Code defines "wages" as "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash." Section 3121(a) lists exceptions to this expansive definition but none apply here. "Employment" is defined, in I.R.C. § 3121(b), as "any service, of whatever nature, performed (A) by an employee for the person employing him." "Remuneration for employment," unless specifically excepted, "constitutes wages even though at the time paid the relationship of employer and employee no longer exists between the person in whose employ the services were performed and the individual who performed them." Treas. Reg. § 31.3121(a)-1(i). As explained in Treas. Reg. § 31.3121(a)-l(c), "[t]he name by which the remuneration for employment is designated is immaterial"; "salaries, fees, bonuses, and commissions . . . are wages if paid as compensation for employment." Congress, by enacting FICA, intended to impose FICA taxes on a broad range of remuneration in order to accomplish the remedial purposes of the Social Security Act. See H.R. Rep. No. 74-615, at 3 (1935) (describing the aims of the Social Security Act).

Both the Supreme Court and this circuit have emphasized the broad, inclusive nature of this definition. For example, in *Soc. Sec. Bd. v. Nierotko*, 327 U.S. 358, 365-66 (1946), the Supreme Court held that back pay awarded to wrongfully

discharged employees under the National Labor Relations Act constituted "wages" for purposes of the Social Security Act of 1935. The Court specifically rejected the argument that "service" as used in the Act should be limited to "only productive activity" and emphasized the broad nature of the definition of FICA "wages":

> The very words 'any service . . . performed . . . for his employer,' *with the purpose of the Social Security Act in mind import breadth of coverage.* They admonish us against holding that 'service' can be only productive activity. We think that 'service' as used by Congress in this definitive phrase means not only work actually done but the entire employer-employee relationship for which compensation is paid to the employee by the employer.

Id. (emphasis added) (quoting I.R.C. § 3121(a)).

In this circuit, we have followed the reasoning of *Nierotko* and have also emphasized that the "phrase 'remuneration for employment' as it appears in § 3121 should be interpreted broadly." *Gerbec v. United States*, 164 F.3d 1015, 1026 (6th Cir. 1999). In *Gerbec*, employees were laid off just before qualifying for pension benefits and they sued under the Employment Retirement Income and Security Act of 1974. The parties settled and the employees received payments pursuant to a settlement agreement. While we found that some of those payments constituted damages for a tort-type personal injury claim and thus were exempt from FICA taxes, we held that damages compensating the plaintiffs for *lost wages*—including back wages or future wages-were subject to income and FICA taxes. We reasoned:

> The holding in *Nierotko* clearly supports the conclusion that awards representing a loss in wages, both back wages and future wages, that otherwise would have been paid, reflect compensation paid to the employee because of the employer-employee relationship, regardless of

> whether the employee actually worked during the time period in question.

Id. Thus, under the holding in *Gerbec,* had the Plaintiffs been terminated without cause and thus wrongfully denied the right they gave up in this case—the right to continued "for cause" employment—those "front pay" wages would have been subject to FICA taxation. *See id.* This is in contrast to the erroneous conclusion by the district court in *Klender,* "[t]he illegal deprivation of [Plaintiffs'] rights would have given rise to a cause of action for damages, and those damages recovered would not be taxable under the Sixth Circuit's reasoning in *Gerbec." Klender v. United States,* 328 F. Supp. 2d 754, 767 (E.D.Mich. 2004).

Both *Nierotko* and *Gerbec* demonstrate the way in which courts have broadly interpreted the definition of "wages" for purposes of FICA.[1] The dissent indicates that our result is "largely ordained" by our choice to define this statute broadly. While we maintain such a construction of this statute is proper, we find a broad construction is not necessary, as we hold the facts presented easily fit within the definition of "wages," for the following reasons.

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[1] The dissent claims that in *Rowan Companies, Inc. v. United States,* 452 U.S. 247 (1981), the Supreme Court rejected "any notion that § 3121 should be interpreted broadly." (emphasis added). Neither the holding in *Rowan*—nor the passage quoted by the dissent from *Rowan*—stands for this proposition. The Court in *Rowan* stated that it was not persuaded by the argument that Congress intended "remuneration" to include a broad range of remuneration which included, in that case, the payment of meals and lodging. The Court did not cite to *Nierotko*, nor did it purport to alter its previous finding that, "[t]he very words 'any service . . . performed . . . for his employer,' with the purpose of the Social Security Act in mind import breadth of coverage." *Nierotko*, 327 U.S. at 365-66 (emphasis added). We further note that we have no disagreement with the principle that courts should look to the language of a statute when interpreting a statute; however, we emphasize that courts also should look to the way in which both the Supreme Court and our court have indicated a statute is to be interpreted—and in the case of FICA "wages," that's broadly.

A.

First, the eligibility requirements for qualifying for a payment—that a teacher served a minimum number of years—indicate the payments were for services performed rather than for the relinquishment of tenure rights. In determining whether a payment constitutes wages, courts have looked to eligibility requirements, specifically longevity, as an important factor. *See Sheet Metal Workers Local 141 Supplemental Unemployment Benefit Trust Fund v. United States*, 64 F.3d 245, 250 (6th Cir. 1995); *Associated Elec. Coop., Inc. v. United States*, 226 F.3d 1322, 1328 (Fed. Cir. 2000); *Abrahamsen v. United States*, 228 F.3d 1360, 1365 (Fed. Cir. 2000). We have consistently held that where a payment arises out of the employment relationship, and is conditioned on a minimum number of years of service, such a payment constitutes FICA wages.

For example, in *Sheet Metal*, we addressed whether distributions to employees from a Supplemental Unemployment Benefit Fund were wages for FICA purposes. *Sheet Metal*, 6 F.3d at 250. The distributions were derived solely from employer contributions, and eligbililty for those distributions was contingent on an employee's length of service. We evaluated whether those payments were "remuneration for employment" and stated that "eligibility requirements provide the *most accurate* test to determine whether a payment is truly in consideration for services." *Id.* at 251 (emphasis added); *see also Associated Elec. Coop., Inc.*, 226 F.3d at 1328 (noting that while the method of computing severance payments, including the length of service and pay rate, were not "dispositive," the method is "a relevant factor in determining whether the payments constitute 'wages'"); *Abrahamsen*, 228 F.3d at 1365 (finding that severance payments constituted FICA wages based in part on the fact that the employer used a "formula based on the departing employee's salary and years of service"); *Cohen v. United States*, 63 F. Supp. 2d 1131,

1134 (C.D. Cal. 1999) (finding that the severance payment was subject to FICA tax where it was only available to employees with twenty or more years of continuous service and noting that courts "look to the eligibililty requirements for determining whether the payments are compensation for services"); *Hemelt v. United States*, 122 F.3d 204, 210 (4th Cir. 1997) ("[K]ey factors in determining the amounts of each award were the length of each employee's tenure with Continental and the salary he received from Continental. . . . [B]ecause the payments from Continental to taxpayers and other class members arose out of their employment relationship, they fit within the statutory and regulatory definition of wages, and FICA taxes were properly withheld from the awards.").

In this case, the severance payments were conditioned upon a teacher having served a certain number of years—exceeding that of obtaining tenure under Michigan law—with the school district. In *Appoloni*, the school district offered a severance payment to teachers who had at least ten years of service with the School District and who were at a high step in the pay scale. Similarly, in *Klender*, the severance payments were only offered to those teachers who had served for a certain number of years in excess of that required to achieve tenure: Klender accepted a buyout requiring 20 or more years of service with the district; Petri accepted a severance package requiring ten or more years of service; and Rase accepted a buyout that was offered to teachers with a minimum of 20 years of service.

Plaintiffs necessarily had to have tenure to be eligible for the buyout. However, longevity—not tenure—was the key fac-tor for determining eligibility because these early retirement payments were offered to encourage teachers at a high pay rate to retire. Thus, the payments at issue in this case, like those in *Sheet Metal*, arose out of the employment relation-

ship, and were conditioned on a minimum number of years of service.

B.

Plaintiffs make much of the fact that they gave up their rights as tenured teachers to continued employment absent just cause for termination. They argue that because the payments were in exchange for the relinquishment of that right, the payments are not "wages" taxable under FICA. This leads us to our next point: just because a teacher relinquishes a right when accepting early retirement does not convert what would be FICA wages into something else.

Plaintiffs maintain that the school districts were "buying" their tenure rights. This point also greatly influences the dissent. Yet, a court must not look simply at what is being relinquished at the point a severance payment is offered, but rather, how the right relinquished was earned. Thus, we cannot understate the importance of the fact that a teacher *earns tenure* by successfully completing a probationary period (Mich. Comp. Laws § 38.71). In other words, a teacher does not obtain tenure at the onset of employment; it is a right that is earned like any other job benefit. Admittedly, the grant of this right is guaranteed and protected by statute. But we fail to see how the fact that this right is protected by statute takes away from the point that it still must be earned through services to the employer.[2]

In any event, the payments at issue were not in exchange *solely* for the tenure rights; they were in exchange for the teachers' early retirement, and, as such, were essentially sev-

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[2] We note that the dissent fails to provide any explanation for why the fact the grant of tenure rights is protected by a statute is important in this case. Many benefits bestowed upon employees are protected by statute—for example, the right to bring suit—but courts have not found this point to be of any import when holding that severance packages in exchange, in part, for the relinquishment of such rights are taxable under FICA. *Abrahamsen*, *228* F.3d 1360.

erance payments. We fail to see how this is different from other severance packages just because a "tenure" right was exchanged. In almost all severance packages an employee gives up something, and we have a hard time distinguishing this case from similar cases where an employee, pursuant to a severance package, gives up rights in exchange. Courts have consistently held that severance payments for the relinquishment of rights in the course of an employment relationship are FICA wages. In fact, we are at a loss to find a case, other than the Eighth Circuit's decision, to hold otherwise.

For example, in *Abrahamsen*, severance payments were conditioned on employees waiving all future claims against the employer. *Abrahamsen*, 228 F.3d 1360. The court noted that the payments were "intended both to induce employees to leave and to settle any claims the employees may have had against IBM." *Id.* at 1364. However, the court found that even though the plaintiffs were relinquishing this right and even though the employer offered this payment, in part, because plaintiffs waived this right, this did not change the wage-like character of the severance payments and those payments were subject to the FICA tax. *Id.; see also Cohen*, 63 F. Supp. 2d at 1135 (finding severance payments subject to FICA tax where plaintiffs voluntarily accepted severance package and, in doing so, waived all rights against the defendant to future employment).

Similarly, in *Associated Electric*, the plaintiff-taxpayers argued their severance payments were not "wages" because the payments were made to union employees "in exchange for valuable rights, i.e., the union's promise not to strike, and thus were not for services performed." *Associated Electric*, 226 F.3d at 1328. Like the court in *Abrahamsen*, the court found that because the employer's motivations "were not solely to avoid labor unrest," the payments constituted FICA "wages." *Id.*

In this case, the school district's motivation was not to buy tenure rights—the motivation was to induce those teachers at the highest pay scales to retire early.[3] Relinquishment of tenure rights was simply a necessary and incidental part of accepting the buyout. In other words, in order to offer the teachers a buyout, the school districts had to ask that they give up their right to future employment—the same as with any severance package Thus, especially in light of the school district's purpose in offering these severance payments, we see no reason to differentiate the relinquishment of tenure rights from the relinquishment of other benefits earned during the course of employment, like the right to bring suit, or rights associated with seniority.

C.

Finally, we agree with the government's position that the most applicable revenue ruling indicates the severance payments are FICA "wages." Revenue rulings are not entitled to the same degree of deference accorded a statute however, some degree of deference is appropriate depending upon "the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control." *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944); *Aeroquip-Vickers, Inc. v. Comm'r*, 347 F.3d 173, 180 (6th Cir. 2003) (finding revenue rulings receive *Skidmore* deference); *but cf. Ammex, Inc. v. United States*, 367 F.3d 530, 535 (6th Cir. 2004) (finding revenue rulings get the same deference as Treasury Regulations). Consideration of all of these factors leads us to conclude that some deference is due to Revenue Ruling 58-301 and Revenue Ruling 75-44.

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[3] For example, in *Appoloni*, the stated purpose of the plan was to "help prevent teacher layoffs and to lessen the Board's economic responsibility in the area of staffing." J.A. at 77.

Plaintiffs argue this case is most analogous to Revenue Ruling 58-301,[4] the revenue ruling relied on by the Eighth Circuit in *North Dakota*. In Revenue Ruling 58-301, an employee with a five-year contract right to employment agreed to relinquish that right during the second year in exchange for a lump sum payment. The IRS concluded that payments for relinquishment of rights under a contract are not "wages" under FICA.

The government contends this case presents an issue more closely related to Revenue Ruling 75-44, where an employee, under a general contract, *"acquired both the rights to security in his employment* and to additional pay or other recognition for longevity" based on his years of service to the employer. Rev. Rul. 75-44 (emphasis added). In exchange for the employee's agreement to refrain from asserting either his seniority rights or job security rights, the employee received a lump sum payment. The IRS held that because the employee "had acquired his relinquished employment rights through his previous performance of services," the payment constituted remuneration for services under the Railroad Retirement Act (the counterpart of FICA for railroad employees). *Id.* We agree with the government and find Revenue Ruling 75-44 to be the most analogous revenue ruling.

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[4] The governments points to a recently issued revenue ruling, Rev. Rul. 2004-110 which purports to supercede Revenue Rulings 58-301 and 55-520 (which Rev. Rul. 58-301 relied on). Revenue Ruling 2004-110 explains that those earlier rulings "erred in their analysis by failing to apply the Code and regulations appropriately to the question of whether the payments made in cancellation of the employment contract were wages." However, Revenue Ruling 2004-110 was issued after the district courts issued opinions in both *Appoloni* and *Klender*. In Revenue Ruling 2004-110, the IRS stated that it would not apply to payments made by an employer prior to January 12, 2005. Because a large portion of the payments to which plaintiffs were entitled under the buyout agreements were made prior to this date, and because we hold that Revenue Ruling 75-44 is analogous to the facts of this case, we decline to rely on Revenue Ruling 2004-110 in making our decision.

In Revenue Ruling 58-301, the employee was granted, at the time of employment, a *contractual right* to employment for five years. In contrast, the Plaintiffs received their statutorily-granted tenure rights after a certain requisite number of *years of service.* As previously emphasized, in Michigan, tenure is automatically granted, pursuant to a statute, after a teacher completes a probationary period. We see this case as one where the teacher earned tenure through his/her "previous performance of services." Rev. Rul. 75-44. Thus, the most analogous revenue ruling, Revenue Ruling 75-44, also indicates that the severance payments at issue are FICA wages.

II.

We recognize our holding, and our reliance on Revenue Ruling 75-44, differs from what the Eighth Circuit held in *North Dakota*; however we believe that we have reached the correct result.[5] As stated in *CSX Corp. Inc. v. United States*, 52 Fed. Cl. 208 (Ct. Fed. Cl. 2002), where the United States Court of Federal Claims disagreed with the holding in *North Dakota*:

> [R]ights to vacation pay, sick pay, layoff pay, *and seniority*—constituted part of the employee's total compensation package and, hence, constituted wages. Therefore, when these job-related benefits are relinquished in favor of a lump-sum payment, the transaction simply amounts to a redemption, paid in cash, of wage amounts

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[5] We also note that *North Dakota* is factually distinguishable. In *North Dakota*, even though the monetary amount of any individuals rights was determined, at least partially, by length of service, the tenure rights in *North Dakota* were created by a single contract made at the onset of the tenure relationship. *North Dakota*, 255 F.3d at 601. Tenure, moreover, was not automatic; the North Dakota Board of Higher Education considered several factors in making tenure determinations, "including scholarship in teaching, contribution to a discipline or profession through research, other scholarly or professional activities, and service to the institution and society." *Id.*

> previously paid in kind. Because a separation payment is simply an exchange of equivalent values, what were wages at the start remain wages at the end.

Id. at 221 (emphasis added). For the reasons previously discussed, we agree with the reasoning of the court in *CSX*. In doing so we give effect to Congress' definition of wages as "all remuneration for employment, *including the cash value of all remuneration (including benefits) paid in any medium other than cash.*" I.R.C. § 3121(a) (emphasis added). Tenure rights were previously paid in kind—job security—and now are being paid in cash.

To summarize, we find of it of great significance that the tenure rights at issue were *earned through service to the employer*. This is for two reasons. First, we see no reason to differentiate tenure rights from any other right an employee earns through service to any employer. As discussed, courts have found the relinquishment of seniority rights, rights to bring suit, and other types of rights in exchange for a severance payment constitute FICA wages. *See e.g. Abrahamsen*, 228 F.3d 1360 (severance payments conditioned upon employees waiving all future claims against the employer); *Associated Elec.*, 226 F.3d at 1328 (severance payments were not "wages" because the payments were made to union employees in exchange for the union's promise not to strike); *Cohen*, 63 F. Supp. 2d at 1135 (court found severance payments subject to FICA tax where plaintiffs voluntarily accepted severance payments and, in doing so, waived all rights against the defendant to future employment). Secondly, because these rights were earned through service rather than contracted for at the time of employment, this suggests Rev. Rul. 75-44 is more on point than Rev. Rul. 58-301.[6]

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[6] Notably, we are not presented with a scenario where a severance payment is exchanged for the relinquishment of rights contracted for *at the time of employment*. We point this out only to emphasize that we need not

We also want to again emphasize the importance of the school district's principal purpose in offering these severance payments. The school district's purpose here was not to "buy" tenure rights. It was to induce those at the highest pay scales to voluntarily retire early. Relinquishment of tenure rights was incidental to the acceptance of the severance payment. A school district could not offer an early retirement payment and permit the teacher to keep his/her tenure and remain employed. The relinquishment of these tenure rights—like the relinquishment of the rights in *Abrahamsen* and *Associated Electric*—was necessary to accepting the severance payment.

Thus, we find that the severance payments at issue easily fall within the definition of FICA wages as "all remuneration for employment." I.R.C. § 3121(a).

CONCLUSION

For the foregoing reasons we AFFIRM the district court's judgment in *Appoloni* and we REVERSE the district court's judgment in *Klender* and remand with instructions to enter summary judgment for the government.

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rely on the recently issued Revenue Ruling 2004-110 in making this decision; and thus, we decline to comment about whether, in light of this recently issued ruling, a severance payment in exchange for rights granted to an employee at the time of employment constitutes FICA wages.

CONCURRING IN PART AND DISSENTING IN PART

GRIFFIN, Circuit Judge, concurring in part and dissenting in part. I concur in the result regarding plaintiff William B. Rase. However, I respectfully dissent as to the other plaintiffs ("plaintiffs"). On this significant tax question for which "[u]niformity among the circuits is especially important in tax cases to ensure equal and certain administration of the tax system," *Nickell v. Comm'r*, 831 F.2d 1265, 1270 (6th Cir. 1987), I would follow the persuasive authority of *North Dakota State University v. United States*, 255 F.3d 599 (8th Cir. 2001). In doing so, I would hold that the payments at issue, with the exception of the payments to plaintiff William Rase, do not constitute "wages" for purposes of the Federal Insurance Contributions Act ("FICA"), I.R.C. §§ 3101-3128. Accordingly, I would affirm the grant of summary judgment in favor of plaintiffs in *Klender* and reverse the grant of summary judgment in favor of the United States in *Appoloni*.

I.

Both cases are certified class actions encompassing former employees of Michigan school districts and public post-secondary educational institutions residing in the Western (*Appoloni*) and Eastern (*Klender*) Districts of Michigan who received early retirement incentive payments from their employers and unsuccessfully applied to the Internal Revenue Service ("IRS") for refunds of FICA taxes withheld on such payments during the previous two years. The facts in each of the cases are not in dispute. Because key facts affect my disagreement with the majority's analysis and conclusion, I will briefly recite the facts crucial to my resolution.

A. Appoloni v. United States

The representative plaintiffs, Donald Appoloni, William Bergemann, and Sandra Engle, are former public school teachers in the Dowagiac Union School District ("Dowagiac") who possessed tenure rights pursuant to the Michigan Teachers'

Tenure Act (the "Tenure Act"), Mich. Comp. Laws §§ 38.71 to 38.191. A public school teacher obtains tenure after satisfactorily completing a four-year (formerly two-year) probationary period of employment, Mich. Comp. Laws § 38.81, and thereafter may be discharged or demoted only "for reasonable and just cause and only as provided in [the Tenure Act]," Mich. Comp. Laws § 38.101. Tenure status also entitles a teacher to a shorter probationary period in any other Michigan school district. Mich. Comp. Laws § 38.92. Appoloni obtained tenure in 1990, Bergemann obtained tenure in 1970, and Engle obtained tenure in 1975.

Appoloni, Bergemann, and Engle all opted to participate in the Employee Severance Plan ("ESP"). The plan is described by plaintiffs as follows:

> Under the plan, teachers who (a) had at least ten years' service with the School District, and (b) were at the highest step of the applicable pay scale, were eligible to elect to participate in the plan by indicating their intent during a window period from November 13, 2000 to January 9, 2001. . . . The plan provided that if more than 30 eligible teachers applied, participation would be determined on the basis of seniority, and that if fewer than 15 applied the plan would be cancelled. *Id.*
>
> Participants in the buyout plan were required to resign from employment with the School District as of June 30, 2001, to "waive . . . all future employment rights, all entitlement to future wage and benefits increases, all rights to participate in any district-sponsored benefit plans," and to "agree not to apply for reemployment" without the School District's consent. . . . In consideration for giving up these rights to future employment, participating teachers were to receive the equivalent of their 1999-2000 annual base salary (but no more than $53,021), in 60 monthly payments over a five-year

period. Teachers' participation in the buy-out plan was entirely voluntary.

B. Klender v. United States

The material facts of *Klender* are substantially similar to the facts of *Appoloni.* Plaintiffs Phyllis Klender and Roger Petri were both employed by the Pinconning Area School District ("Pinconning"), although they retired at slightly different times and therefore participated in different severance plans. Plaintiff William Rase was employed by the West Branch-Rose City Area School District ("West Branch-Rose"). The features of the applicable severance plans are outlined below.

1. Phyllis Klender

Like Dowagiac, Pinconning also created an Employee Severance Plan ("ESP") designed to induce long-term employees to leave their jobs. The plan was available to teachers who had twenty or more years of service with Pinconning as of June 30, 2000. All teachers who accepted the ESP were paid the same amount: $46,800 if retired by June 30, 2000; and $43,200 if retired by June 30, 2001. The uniform ESP payment amount was arbitrary in the sense that it bore no relationship to an individual teacher's loss of actual wages. The Pinconning employees also agreed to give up all future employment rights, including "any and all claims existing in equity or law under federal and state law or board policy pertaining to any right to reappointment or tenure rights by virtue of any expressed agreements or oral understandings." The employees further relinquished any right to bring suit against the school district under "Title VII of the U.S. Civil Rights Act of 1964 or any other statute, constitutional provision or common law theory related to employment, employment discrimination or his/her separation from employment" and under the "Age Discrimination in Employment Act of 1967 and the Older Workers Protection Act of 1990."

Phyllis Klender, a tenured teacher eligible for the plan, agreed to participate and retired effective June 30, 2000, after signing the requisite releases. After Pinconning deducted FICA taxes from subsequent severance plan payments distributed to Klender, Klender timely filed a claim for a refund with the IRS. On January 23, 2002, the IRS denied Klender's claim for a refund.

2. Roger Petri

Pinconning offered Roger Petri a similar plan in 1996. All teachers with a minimum service of ten years were eligible to receive the uniform sum of $37,500, irrespective of an individual's loss of actual wages. Like Klender's plan, Petri's ESP plan required him to relinquish rights to continued employment. Although the 1996 agreement did not specifically list tenure rights, participating employees agreed

> to fully and completely waive, discharge, release and hold Pinconning Area Schools and the Pinconning Area Education Association harmless . . . from any and all liability, claims, charges, demands and/or causes of action of any kind whatsoever . . . including, but not limited to, claims for breach of contract, deprivation of constitutional rights, claims of wrongful discharge and/or claims of discrimination. . . .

The agreement further "acknowlege[d] that the Program benefit constitutes compensation which the Teacher would not otherwise be entitled to."

Having obtained tenure in 1973, Roger Petri qualified for the severance program and, accordingly, accepted the buy-out offer, which included the release document, in February of 1997. As with Klender, Pinconning deducted FICA taxes from the ESP payments Petri received. On August 29, 2001, Petri filed a claim for a refund with the IRS for FICA taxes withheld on the payments he received, and, on October 23, 2001, the IRS denied Petri's claim for a refund.

3. William Rase

William Rase worked in the West Branch-Rose School District. Like the other districts, West Branch-Rose devised a plan to give qualified teachers a fixed sum in exchange for the teachers' agreement to retire early. The West Branch-Rose plan differed, however, because it was included in the "Master Agreement;" that is, the contract between the school district and the chapter of the teacher's union that represented the district's teachers, including Rase. The actual sum an employee received was dependent upon the number of years the teacher was involved in a Michigan public employees' retirement plan and varied between $10,000 and $30,000. Unlike the other ESPs, there was no admissible evidence presented that the teachers who chose to participate in the early retirement plan were contractually required to release statutory rights to receive the severance payments. Nevertheless, Rase claims, by way of affidavit, that the payments were contingent upon the relinquishment of his tenure rights in exchange for the ESP payments. Rase qualified for the early retirement plan because he was employed by West Branch-Rose as a teacher since 1979 and achieved tenure in 1981. After Rase committed to the plan in early 2001, West Branch-Rose subsequently deducted FICA taxes from the payments to Rase. Like the other plaintiffs, Rase unsuccessfully filed a claim for a refund with the IRS.

I concur in the result reached by the majority with respect to William Rase. I would hold that the claim by Rase fails when confronted by the government's motion for summary judgment because there was no obligation by Rase to relinquish his statutory tenure rights. Although Rase proffered his subjective opinion, by affidavit, that the payment was contingent upon his relinquishment of claims pursuant to the Michigan Tenure Act, no factual evidence supports this conclusory assertion. FED. R. CIV. P. 56(e). Accordingly, I concur with the majority that Rase's ESP payments were subject to FICA taxes.

II.

These cases present an issue of statutory construction. In this regard, the inquiry begins with the fundamental purpose of judicial construction of statutes, which is to ascertain and give effect to the original meaning of the words used by Congress:

> [W]e begin with the understanding that Congress "says in a statute what it means and means in a statute what it says there," *Connecticut Nat. Bank v. Germain*, 503 U.S. 249, 254, 112 S. Ct. 1146, 117 L.Ed.2d 391 (1992). As we have previously noted in construing another provision of § 506, when "the statute's language is plain, 'the sole function of the courts'"—at least where the disposition required by the text is not absurd—"'is to enforce it according to its terms.'" *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241, 109 S. Ct. 1026, 103 L.Ed.2d 290 (1989) (quoting *Caminetti v. United States*, 242 U.S. 470, 485, 37 S. Ct. 192, 61 L.Ed. 442 (1917)).

Hartford Underwriters Ins. Co. v. Union Planters Bank, NA., 530 U.S. 1, 6 (2000).

As Justice Scalia has further elaborated:

> The text is the law, and it is the text that must be observed. I agree with Justice Holmes's remark, quoted approvingly by Justice Frankfurter in his article on the construction of statutes: "Only a day or two ago—when counsel talked of the intention of a legislature, I was indiscreet enough to say I don't care what their intention was. I only want to know what the words mean."[28] And I agree with Holmes's other remark, quoted approvingly by Justice Jackson: "We do not inquire what the legislature meant; we ask only what the statute means."[29]

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[28] "Felix Frankfurter, *Some Reflections on the Reading of Statutes*, 47 Colum. L. Rev. 527, 538 (1947).

[29] Oliver Wendell Holmes, *Collected Legal Papers* 207 (1920), *quoted in Schwegmann Bros. v. Calvert Distillers Corp.*, 341 U.S. 384, 397 (1951) (Jackson, J., concurring).

ANTONIN SCALIA, A MATTER OF INTERPRETATION: FEDERAL COURTS AND THE LAW 22-23 (1997).

The FICA defines "wages" as "all remuneration *for employment*, including the cash value of all remuneration (including benefits) paid in any medium other than cash. . . ." 26 U.S.C. § 3121(a) (emphasis added). "Employment" is further defined as *"any service*, of whatever nature, performed . . . by an employee for the person employing him. . . ." *Id.* at § 3121(b) (emphasis added). Thus, the statute's plain language raises the issue of whether the plaintiffs received their ESP remuneration for "any service" performed by them for their employer.

Where, as here, no statutory definitions exist, courts may refer to dictionary definitions for guidance in discerning the plain meaning of a statute's language. *United States v. Edward Rose & Sons*, 384 F.3d 258, 263 (6th Cir. 2004); *Cleveland v. City of L.A.*, 420 F.3d 981, 989 (9th Cir. 2005); *see MCI Telecomm. Corp. v. Am. Tel. & Tel. Co.*, 512 U.S. 218, 225-29 (1994) (using dictionary definitions to interpret the word "modify").

The ordinary, common meaning of the word "services" is "[a]n act or a variety of work done for others, especially for pay." AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE 222 (4th ed. 2000). Other major English language dictionaries are to the same effect:

> "An act of serving; a duty or piece of work done for a master or superior. OXFORD ENGLISH DICTIONARY, http://www.oed.com (enter term "service"); "the work performed by one that serves <good service> b: useful labor that does not produce a tangible commodity—usually used in plural <charge for professional ser-

vices>[,] MERRIAM-WEBSTER ONLINE DICTIONARY, http://www.m-w.com (enter term "service"); "The performance of work or duties for a superior or as a servant . . . . 4. a. Work done for others as an occupation or business," DICTIONARY.COM, http://dictionary.reference.com/(enter term "service").

After my review of these common definitions and *Social Security Board v. Nierotko*, 327 U.S. 358 (1946), which held that the term "service" is not limited to "productive activity," but includes compensation for the loss of actual wages, I conclude, consistent with the Eighth Circuit, the United States District Court for the Western District of Pennsylvania, and the United States District Court for the Eastern District of Michigan, that the ESP payments were made in exchange for the relinquishment of plaintiffs' statutory and constitutionally-protected tenure rights, rather than remuneration for "services" to the school districts. Similar to the payment of meals[1] and lodging in *Rowan Companies, Inc. v. United States*, 452 U.S. 247 (1981), and the release of tort claim damages in *Gerbec v. United States*, 164 F.3d 1015, 1026 (6th Cir. 1999), the ESP payments, although arising in the employment setting, were not remuneration for "any service" performed by plaintiffs. Rather, the ESP payments were a "clear, separate, and adequate consideration" exchanged for the relinquishment of plaintiffs' vested and bona fide statutory rights to tenure.

III.

Prior to *Rowan*, a plausible argument could be made that the term "wages" as used in the FICA should be "broadly construed." *See Nierotko*, 327 U.S. at 355-366. Relying on *Nierotko* and obiter dictum from our decision in *Gerbec*, 164

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[1] *See also Cent. Ill. Pub. Serv. Co. v. United States*, 435 U.S. 21 (1978) (holding reimbursements to employees for expenses did not qualify as "wages").

F.3d. at 1015 ("'remuneration for employment' as it appears in [26 U.S.C.] § 3121 should be interpreted broadly"), the majority reaches a result which is largely ordained by its choice of a rule of statutory construction.

In my view, the statute at issue, like all statutes, should not be construed "broadly," "narrowly," "strictly," or "liberally," but rather fairly and reasonably. In this regard, I agree with Justice Scalia that "[a] text should not be construed strictly, and it should not be construed leniently; it should be construed reasonably, to contain all that it fairly means." SCALIA, A MATTER OF INTERPRETATION at 23.

Furthermore, any notion that § 3121 should be interpreted broadly, rather than fairly and reasonably, was rejected by the Supreme Court in *Rowan*, 452 U.S. at 263. In *Rowan*, the government unsuccessfully argued that the holding of *Central Illinois* should not apply to the term "wages" as contained in the FICA. *Id.* at 251-52.[2] The government contended that the definition of "wages" for purposes of the FICA should be given a broader and more expansive interpretation. *Id.* The government's position was rejected by the Supreme Court, and the treasury regulation at issue was declared invalid. *Id.* at 263. The Court summarized its holding as follows:

> We conclude that Treas. Reg. §§ 31.3121(a)-l(f) and 31.3306(b)-1(f) fail to implement the statutory definition of "wages" in a consistent or reasonable manner. The plain language and legislative histories of the relevant Acts indicate that Congress intended its definition to be interpreted in the same manner for FICA and FUTA as for income-tax withholding. The Treasury Regulations on which the Government relies fail to do so, and their inconsistent and unexplained application undermine the contention that Congress nonetheless endorsed them. As

[2] The government repeats this discredited argument in its appellate brief in *Klender*.

> Congress did intend a consistent interpretation of its definition, these Treasury Regulations also are inconsistent with the Court's reasoning in *Central Illinois*.
>
> We therefore hold that the Regulations are invalid, and that the Service erred in relying upon them to include in the computation of "wages" the value of the meals and lodging that petitioner provided for its own convenience to its employees on offshore oil rigs. The judgment of the Court of Appeals is reversed.

Id.

Although Congress amended 26 U.S.C. § 3121(a)[3] in response to *Rowan*, thus allowing differing regulatory treatment of "wages" for purposes of income tax withholding and the FICA, the "broad interpretation" of the definition of "wages" for FICA purposes has not been restored.

After construing the statute at issue in a fair and reasonable manner, consistent with the words used by Congress, I would hold that, with the exception of plaintiff William Rase, the ESP payments were made in exchange for the relinquishment of plaintiffs' statutory and constitutionally protected tenure rights, rather than as remuneration for services to the school districts.[4]

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[3] In 1983, Congress added the following additional language to 26 U.S.C. § 3121(a):

> [N]othing in the regulations prescribed for purposes of chapter 24 (relating to income tax withholding) which provides an exclusion from "wages" as used in such chapter shall be construed to require a similar exclusion from "wages" in the regulations prescribed for purposes of this chapter.

Social Security Amendments of 1938, Pub. L. No. 98-21, § 327(b)(1) 97 Stat. 65 (1983).

[4] Were we to employ a result-oriented rule of statutory construction, any doubt should be resolved in favor of the taxpayer, not the government tax collector. *See Hassett v. Welch*, 303 U.S. 303, 314 (1938) ("[I]f doubt

IV.

The weight of authority from the circuits also supports plaintiffs' position. In *Gerbec*, the plaintiffs successfully sued their employer for damages arising from ERISA violations, and a question arose whether the resulting payments were subject to FICA and income taxes. 164 F.3d at 1026. We held that "any damages attributable to wages [plaintiffs] would have received had they not been wrongly terminated should also be subject to the FICA taxes they would have paid on those wages had they not been wrongly terminated." *Id.* at 1026-27. Significantly, we also held that the plaintiffs' tort damages were not subject to FICA taxation. *Id.* in short, only the portion of the damages that compensated plaintiffs for the loss of actual wages[5] was taxable pursuant to FICA. *Id.*

The majority acknowledges this distinction, holding that awards representing a loss in wages that otherwise would have been paid are subject to FICA taxes. Yet there is no question that the severance payments would *not* have been paid had plaintiffs not relinquished their tenure rights. Were it not for their statutory tenure rights, plaintiffs would be at-will employees, subject to discharge without cause or consideration. *See generally Toussaint v. Blue Cross-Blue Shield*, 292 N.W.2d 880 (Mich. 1980). Indeed, this is evidenced by similarly situated employees who worked the same number of years and were entitled to the same salary levels as plaintiffs, who did not receive the ESP payments. The ESP payments

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exists as to the construction of a taxing statute, the doubt should be resolved in favor of the taxpayer . . . .").

[5] In Michigan, plaintiff may sue in tort for loss of earning capacity, rather than loss of actual wages. *Prince v. Lott*, 120 N.W.2d 780 (Mich. 1963); Michigan Supreme Court Committee on Model Civil Jury Instructions, *Michigan Standard Civil Jury Instruction*, 50.06 (2006), http://courts.mi.gov/mcji/MCJI.htm. Damages recovered for loss of earning capacity are not subject to FICA taxation. *Dotson v. United States*, 87 F.3d 682 (5th Cir. 1996).

therefore were not made in exchange for any "service" that plaintiffs performed or were wrongfully prevented from performing, but, rather, in exchange for the relinquishment of a separate statutory right. Accordingly, the majority's conclusion that any damages arising from a lawsuit following the illegal deprivation of the tenure right would be taxable under *Gerbec* is not correct.

The uniformity in the amount of the ESP payments is further evidence that this consideration was not the sum of each individual teacher's loss of actual wages. The ESP payments are neither tailored, on a case-by-case basis, to the recipient's employment record nor to the recipient's current wage rate. Moreover, the ESP payments are not equivalent to each teacher's loss of earning capacity because the age of each teacher varies considerably. In sum, there is no correlation between the amount of the ESP payments and the teachers' individual employment circumstances that would lend support to the majority's theory that the ESP payments constitute discretely earned wages for purposes of income tax withholding and the FICA. As *Gerbec* holds, remuneration for actual wage loss, past and future, is subject to FICA taxation. However, payment in exchange for the relinquishment of other vested and bona fide claims such as tort and statutory rights are not subject to FICA taxation.

The majority is persuaded that the ESP payments were not made in exchange for the plaintiffs forfeiting their tenure rights by the fact that eligibility to participate in the ESP was conditioned upon a teacher working for a specific duration. This, the majority concludes, is an important, if not dispositive, factor in determining whether payments "arise" from an employment relationship for purposes of FICA taxation. I agree with the proposition that where an employment contract and past service to the employer constitute the consideration for the payment, such payment is indeed inextricably tied to "services" rendered the employer. However, the present cir-

cumstances do not yield a similar conclusion. The majority's rationale that the ESP payments were made in consideration of the plaintiffs' past years of service is belied by the fact that similarly situated employees who did not relinquish their tenure rights received nothing. The majority further ignores the critical fact that the rights relinquished by plaintiffs stemmed from the entirely separate grant of authority created by state statute and, thus, required specific relinquishment of statutorily protected tenure rights. For these reasons, I would hold that it was this relinquishment, not the years of service, for which the school districts paid.

In *North Dakota*, the Eighth Circuit examined a materially indistinguishable set of facts, 255 F.3d at 599.[6] Faced with the presentation of a correspondingly similar issue, the *North Dakota* court differentiated the tenured faculty from the non-tenured administrators, stating that "the administrators who were not on the academic staff were [not] anything other than at-will employees entitled only to extended notice before termination." *Id.* at 608. Accordingly, the non-tenured employees' severance payments were subject to FICA taxes, because the payments corresponded to the number of years worked rather than the forfeiture of a due process right. *Id.* While the tenure-qualification process at issue was more rigorous, *id.* at 606, Michigan law similarly recognizes tenure as a property right and provides procedural safeguards, qualifications, and protections for the tenure rights of public school teachers. *See Tomiak v. Hamtramck Sch. Dist.*, 397 N.W.2d 770, 780 (Mich. 1986); *see also Klender*, 328 F. Supp. 2d at 765-67 (discussing laws that govern the process of tenure in Michigan).

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[6] Although the majority attempts to distinguish the facts, particularly on the issue of tenure, the salient fact—a statutorily protected due process consideration—renders the cases materially indistinguishable. This is evident from the Eighth Circuit's distinction between tenured and non-tenured employees who had the same number of years of service.

Although *North Dakota* is not controlling authority in this Circuit, the decision is entitled to considerable deference. *See Aeroquip-Vickers, Inc. v. Comm'r*, 347 F.3d 173, 181 (6th Cir. 2003) ("'Uniformity among the circuits is especially important in tax cases to ensure equal and certain administration of the tax system. We would therefore hesitate to reject the view of another circuit.'" (quoting *Nickell*, 831 F.2d at 1270)).

In addition to *North Dakota*, the District Court for the Western District of Pennsylvania recently held that early retirement incentive payments made to tenured faculty and administrators at the University of Pittsburgh were not subject to FICA taxes. *Univ. of Pittsburgh v. United States*, No. 04-1616, 2005 WL 3619245 (W.D. Pa. Oct. 18, 2005) (magistrate decision), *adopted*, November 21, 2005. Analyzing virtually indistinguishable circumstances, the court found the rationale of *North Dakota* persuasive, holding that: (1) no "service" was rendered in exchange for the payments, thus rendering the payments an exchange for the "relinquishment of protected property rights," *id.* at **11-12; and (2) non-tenured faculty members offered the same payments were subject to FICA taxation, as they possessed only an "expectation of continuing employment," *id.* at *12.

Finally, in this appeal, the district court opinion in *Klender* offers a well-reasoned analysis in support of its conclusion that the contested payments are not subject to FICA taxation. *Klender*, 328 F. Supp. 2d at 760-67.

V.

The majority relies on Revenue Rulings to buttress its conclusion that the ESP payments are subject to FICA taxation. However, the Revenue Rulings at issue, which are persuasive authority at best, do not preclude the conclusion that the subject ESP payments are not taxable pursuant to FICA. *See Aeroquip-Vickers, Inc.*, 347 F.3d at 180 (holding that revenue rulings are not entitled to *Chevron* deference (i.e. when a non-

arbitrary agency regulation controls) but are reviewed under the *Skidmore* standard (i.e. regulations have the power to persuade, as they are the official IRS interpretation, but do not control); *North Dakota,* 255 F.3d at 604 n.6 ("[R]evenue rulings do not have the force of law, [but] they are entitled to respectful consideration . . . .") (internal quotation omitted).

The parties cite four Revenue Rulings—58-301, 74-252, 75-44, and 2004-110—as relevant to this case. The courts in *North Dakota* and *Pittsburgh* relied on three of these rulings—58-301, 74-252, and 75-44. Although Ruling 2004-110 generally supports the government's position, plaintiffs contend that it was promulgated in anticipation of litigation.[7]

In Revenue Ruling 58-301, the IRS determined that FICA taxes were not owed on a lump-sum payment received by an employee as consideration for the early termination of his five-year employment contract. 1958-1 C.B. 23, 1958 WL 10630. The IRS further determined that the employee received the lump-sum payment in exchange for the relinquishment of his contractual rights (i.e., to be employed for the full five years) and therefore not subject to FICA taxation. *Id.*

In contrast, however, the IRS concluded in Revenue Ruling 74-252, that payments made to an employee to unilaterally terminate his three-year employment contract were taxable as FICA wages because the contract gave the employer the right to terminate the contract at any time, so long as the employer paid the employee an additional six-month salary, which it did. 1974-1 C.B. 287, 1974 WL 34867. The Ruling distinguished 58-301 by noting that, in 74-252, the employee

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[7] Plaintiffs note that Ruling 2004-110 specifically states that it would not apply to payments made by an employer prior to January 12, 2005. Plaintiffs' observation is well-taken; even if the Court were persuaded by this Ruling, a large portion of plaintiffs' payments would remain unaffected because the ESP payments predate its applicability. (Rev. Rul. 2004-110, 2004-50 I.R.B. 960, 962)).

received payment pursuant to an already-present employment contract. *Id.*

In the instant case, I would hold that the ESP payments are most like the payments in Ruling 58-301, as they did not arise from the employment contract. Indeed, the ESP payments are ultimately distinguishable from either Ruling, as they were made in exchange for an entirely separate statutory right.

Finally, in the case that the majority finds most persuasive, Revenue Ruling 75-44 held that a lump-sum payment given to a railroad employee to buy-out his seniority rights earned pursuant to a general employment contract was taxable under the Railroad Retirement Tax Act (FICA's counterpart for railroad employees). 1975 C.B. 15, 1975 WL 34658. After noting that the employee was only an at-will employee, but received higher pay as a result of his seniority rights, the IRS concluded that this remuneration compensated the employee exclusively for past services earned. *Id.* However, Ruling 75-44 is distinguishable from the present case because plaintiffs' rights in this case arise not from their employment contract, but rather from state law. Indeed, because of the rights bestowed by Mich. Comp. Laws § 38.101, plaintiffs possessed an alternative source of consideration, and, accordingly, the school districts had an alternative basis for providing ESP payments.

VI.

For the foregoing reasons, with the exception of William Rase, I would hold that the ESP payments to the Michigan teachers do not constitute "wages" for purposes of FICA. Accordingly, I would affirm the grant of summary judgment in favor of plaintiffs in *Klender* and reverse the grant of summary judgment in favor of the United States in *Appoloni*.

APPENDIX B

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
NORTHERN DIVISION

[Filed Aug. 2, 2004]

Case Number 02-10082-BC
Honorable David M. Lawson

PHYLLIS F. KLENDER, WILLIAM B. RASE, ROGER J. PETRI, and all similarly situated individuals,
Plaintiffs,

v.

UNITED STATES OF AMERICA,
Defendant.

OPINION AND ORDER GRANTING PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT AND DENYING GOVERNMENT'S MOTION FOR SUMMARY JUDGMENT

This case presents the issue of whether installment payments toward a fixed sum made to school teachers by their school districts as an inducement to relinquish their tenure rights and retire early constitute "wages" from which deductions must be made under the Federal Insurance and Contribution Act (FICA), 26 U.S.C. § 3101, *et seq.* Although this issue has not yet been addressed by the Sixth Circuit, a similar case decided by the Eighth Circuit answered that question in the negative. See *North Dakota State Univ. v. United States*, 255 F.3d 599 (8th Cir. 2001). The government urges this Court not to follow *North Dakota* because the early retirement program that benefited the tenured university professors in that case is materially different from those presented here, and because, in the government's view, *North*

Dakota was wrongly decided. The Court believes, however, that a critical reading of the statutory language, as interpreted by Revenue Rulings issued by the Department of Treasury and guided by Supreme Court and Sixth Circuit precedent, leads ineluctably to the conclusion reached by the Eighth Circuit.

I.

The material facts of the case are not in dispute. The named plaintiffs are all public school teachers who had worked for several years in their respective school districts and achieved tenured status. It appears that long-term teachers command larger salaries then newer employees under the various districts' collective bargaining agreements as a result of longevity premiums. Consequently, over the last few years some school districts have offered severance plans designed to induce more senior teachers to separate from the district in exchange for a fixed sum payable in regular installments.

Participation in the programs was entirely voluntary. However, each of the severance plans, described in more detail below, required the teacher to relinquish his or her right to continued employment as a tenured teacher under Michigan's Teacher Tenure Act, Mich. Comp. Laws § 38.71., *et seq.*, and some of the plans limited the rights of the teachers to seek re-employment with the district. All of the named plaintiffs availed themselves of the opportunity to participate, and after they severed their employment they began to receive their installment payments. The respective school districts withheld from each payment an amount for taxes under FICA. The teachers contended that the payments under the incentive programs did not constitute "wages" within the meaning of FICA, and they each sought a refund from the Internal Revenue Service (IRS). When the refunds were refused, this suit was commenced.

The plaintiffs moved to certify the action as a class action, and on June 18, 2003 the Court entered an order granting the

plaintiffs' motion and certifying the class. Motions for reconsideration of the order then were filed by both parties. On November 4, 2003, this Court entered an order granting in part and denying in part the motions for reconsideration and amended the class certification order to define the following class:

> all individuals a) formerly employed by public school districts, public colleges or universities or community colleges; b) residing in the Eastern District of Michigan; c) who received from the school district, public colleges or universities or community colleges, a payment in exchange for a property right or the right to continued employment absent just cause for termination, pursuant to an Early Retirement Incentive Plan; d) who applied to the Internal Revenue Service for a refund of the portion of said payment that was withheld as taxes and other payroll deductions as if from wages pursuant to the Federal Insurance Contribution Act within two years from the time the tax was paid; and e) whose refund was refused by the Internal Revenue Service on or after March 27, 2000, or who filed a claim for a refund before September 27, 2001 that was not acted upon before March 27, 2002.

Order, Nov. 4, 2004, at 8. Prior to entry of that order, the plaintiffs filed an amended complaint on August 1, 2003 in which they amended their prayer for relief to include a request for attorney fees.

Plaintiffs Phyllis Klender and Roger Petri both were employed by the Pinconning Area School District, although they did not retire early under the same plan. Plaintiff William Rase was employed by the West Branch-Rose City Area School District. Since the government has suggested that differences between the incentive plans in this case and the one discussed by the Eighth Circuit in *North Dakota* might be

material, the Court will review the salient features of the plans in which the respective named plaintiffs participated.

A. Phyllis Klender

In 2000, the Pinconning Area Schools in Pinconning, Michigan created an "Employee Severance Plan" designed to induce long-term employees to leave their jobs. In the plan, the school district stated that it had "determined that a limited program of severance of employment among a specified group of employees would permit the District to control salary and operating costs and better fulfill its educational purposes." Pl.s' Mot. Summ. J. Ex. C; Gov't Mot. Summ, J. Ex. 2. The plan was available to "teaching staff who have twenty (20) or more years of service with Pinconning Area Schools as of June 30, 2000." *Ibid.* The school district offered employees who chose to participate in the plan certain benefits that were categorized under two separate options. Under "Option 1," the employee had to separate from the school district on June 30, 2000 and would receive "$46,800 divided into 72 monthly payments (six (6) years)." *Ibid.* Under "Option 2," the employee had to separate from the district on June 30, 2001 and would receive "$43,200 divided into 72 monthly payments (six (6) years)." *Ibid.*

In exchange for the payments, the employees agreed to give up the following rights:

> In consideration of benefits to be received under the Plan, the employee shall waive (effective on the date of his/her separation from district service) all future employment rights, all entitlements to future wages and benefits increases, all rights to participate in any district-sponsored benefit plans (other than the right to payments under this Plan and the right to purchase continuation of health, dental and vision benefits under COBRA) and shall agree not to apply for reemployment (unless such application is consented to by the district).

An employee who elects to participate in the Plan shall be required to execute the following documents which are results of the negotiated agreement between the District and the Pinconning Education Association:

Exhibit B—"Indication of interest—Notice of Election Form"
Exhibit C—"Employee Severance Plan"
Exhibit D—"Release and Waiver of Claims Agreement"
Exhibit E—"Notice of Enrollment"
Exhibit F—"Tabulation of Eligibility and Non-Eligibility"

Ibid. The indication of interest form is a document wherein the employee agreed to resign from the school district by a certain date. The employee severance plan form is the document in which the employee elected option one or two under the plan. The notice of enrollment and tabulation of eligibility forms are documents providing the applicant with general information about the plan. *See e.g.*, Pl.s' Ex. C; Gov't Ex. 4-6.

The "Release and Waiver of Claims Agreement" form constituted a broad release of claims against the district. The form provides, in pertinent part, that

> [t]he signature of the Employee herein constitutes the rel ease and waiver of any and all claims against the District, District representatives and the Pinconning Education Association/MEA/NEA including, but not limited to, any rights to reappointment in any subsequent fiscal school year, and to any and all claims existing in equity or law under federal and state law or board policy pertaining to any right to reappointment or tenure rights by virtue of any expressed agreements or oral understandings. Further, the Employee hereby waives any and all claims, causes of actions, grievances, or complaints against the District and District representatives relating

> *to resignation of employment, relinquishment of any and* all tenure rights and rights to reappointment.

Pl.'s Ex. C; Gov't Ex. 6. The form also states that the employee waives, among other things, his or her rights to bring suit under "Title VII of the U.S. Civil Rights Act of 1964 or any other statute, constitutional provision or common law theory related to employment, employment discrimination or his/her separation from employment" and under the "Age Discrimination in Employment Act of 1967 and the Older Workers Protection Act of 1990." *Ibid.*

In the fall of 1999, the Pinconning Area Schools offered plaintiff Phyllis Klender the opportunity to participate in the plan and retire early from her employment. Klender qualified for the plan having worked as a librarian for the Pinconning Area Schools since January 1968. Klender obtained tenure from the school district in 1971 after successfully completing her probationary period and receiving positive evaluations. On December 14, 1999, Klender signed the indication of interest form, elected "Option 1" on the employee severance plan form, and thus she agreed to retire early on June 30, 2000 in exchange for the sum of $46,800, payable in seventy-two monthly payments. She signed the "Release and Waiver of Claims Agreement" form on the same date.

The Pinconning Area Schools deducted FICA taxes from the payments Klender received under the severance plan. On December 27, 2001, Klender filed a claim for a refund, Form 843, with the IRS for FICA withheld on the payments she received under the severance plan. On January 23, 2002, the IRS denied Klender's claim for a refund.

B. Roger Petri

The Pinconning Area Schools offered a similar severance plan in 1996 to plaintiff Roger Petri. The "Voluntary Teacher Severance Incentive Program" was available in 1996 to all teachers who had ten years of experience with the school dis-

trict as of June 30, 1997. Under the 1996 program, an employee was guaranteed a payment of $2,000 for electing to participate in the program, but if ten or more eligible employees elected to participate in the program, then the program provided that "all such individuals shall receive $35,000.00 in addition to the $2,000.00 minimum benefit." Pl's Ex. E; Gov't Ex. 8. The payments would be made to participants over a period of up to three years.

Like the 2000 severance plan, the 1996 Pinconning severance program required that teachers relinquish their rights to continued employment. In exchange for the payments, teachers made the following agreement:

> The Teacher acknowledges and agrees in consideration of the receipt of severance payments . . . to fully and completely waive, discharge, release and hold Pinconning Area Schools and the Pinconning Area Education Association harmless . . . from any and all liability, claims, charges, demands and/or causes of action of any kind whatsoever, known or unknown, based upon any factor event occurring or existing prior to the execution of this Agreement, including, but not limited to, claims for breach of contract, deprivation of constitutional rights, claims of wrongful discharge and/or claims of discrimination . . . and/or claims for personal injuries and/or damages . . . arising during and from his/her employment and/or from his/her severance and retirement from Pinconning Area Schools pursuant to the terms of the Program.

Ibid.

Roger Petri had worked as a teacher for the Pinconning Area Schools since October 1971 and therefore qualified for the severance program. He obtained tenure from the school district in 1973 by successfully completing his probationary period and successfully meeting the standards of teaching set

forth by the board of education and the state of Michigan. He maintained his tenure after the first six years of teaching by receiving good evaluations from the district. In February 1997, Petri notified the school district of his intent to retire early in June 1997 and signed the necessary paperwork, including the release document. Apparently, the school district found at least nine other individuals willing to participate since Petri states that he received "approximately $37,500" to participate in the 1996 Pinconning severance program. *Ibid.* Although not specifically stated in the release document, Petri claims that he agreed to retire and relinquish his tenure rights in exchange for the school district paying him the $37,500. This amount was to be paid over a period of three years.

The Pinconning Area Schools deducted FICA taxes from the payments Petri received under the program. On August 29, 2001, Petri filed a claim for a refund, Form 843, with the IRS for FICA withheld on the payments he received from the school district. On October 23, 2001, the IRS denied Petri's claim for a refund.

C. William Rase

Like the Pinconning Area Schools, the West Branch-Rose City Area School District devised a plan to give certain teachers a fixed sum in exchange for the teachers' agreement to retire early. The West Branch "Early Retirement" plan was incorporated into the "Master Agreement" between the school district and the West Branch-Rose City Education Association. *See* Pl's Ex. G; Gov't Ex. 11. Under the plan, any teacher with twenty years or more of service to the school district could receive between $10,000 and $30,000 if he or she retired early. The actual amount received depended on the number of years the teacher was involved in a Michigan public employees' retirement plan. There is no indication that the teachers who chose to participate in the early retirement plan had to agree to release certain rights to receive the benefit payment.

Plaintiff William Rase qualified for the early retirement plan because he had worked as a teacher for the school district since September 1979. Rase obtained tenure from the school district in 1981 by successfully completing his probationary period and meeting the standards of teaching set forth by the board of education and state of Michigan. He maintained his tenure after the first six years of teaching by receiving good evaluations from the district. In February 2001, Rase agreed to voluntarily retire in exchange for a $30,000 payment. Although not specifically stated in the "Early Retirement" plan, Rase claims that he agreed to retire and relinquish his tenure rights in exchange for the school district paying him the $30,000.

The West Branch-Rose City School District deducted FICA taxes from the payment Rase received under the plan. On October, 16, 2001, Rase filed a claim for a refund, Form 843, with the IRS for FICA withheld on the payments he received under the plan. On December 6, 2001, the IRS denied his claim for a refund.

* * * *

As mentioned, the parties filed cross motions for summary judgment on January 30, 2004. Both parties have filed answers in opposition to the respective motions and replies in support of their motions. The Court heard oral argument on May 19, 2004 and took the motions under advisement. This matter is ready for decision.

II.

Both the plaintiffs and the defendant have moved for summary judgment; neither has argued that there are material facts in dispute. Rather, each party claims entitlement to a judgment in its favor as a matter of law. "By its very nature, a summary judgment does not involve the determination of disputed questions of fact, but is confined to purely legal issues." *Eisenmann Corp. v. Sheet Metal Workers Intern.*

Assn Local No. 24, AFL-CIO, 323 F.3d 375, 380 (6th Cir, 2003) (citing FED. R. CIV. P. 56(c) (summary judgment may be granted only if "there is no genuine issue as to any material fact and . . . the moving party is entitled to a judgment as a matter of law") and *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986)). The Court must view the evidence and draw all reasonable inferences in favor of the non-moving party, and determine "whether the evidence presents a sufficient disagreement to require submission to a jury or whether it is so one-sided that one party must prevail as a matter of law." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 251-52 (1986).

"The fact that the parties have filed cross-motions for summary judgment does not mean, of course, that summary judgment for one side or the other is necessarily appropriate." *Parks v. LaFace Records*, 329 F.3d 437, 444 (6th Cir. 2003). Thus, when this Court evaluates cross motions for summary judgment, it "must evaluate each motion on its own merits and view all facts and inferences in the light most favorable to the nonmoving party." *Westfield Ins. Co. v. Tech Dry, Inc.*, 336 F.3d 503, 506-07 (6th Cir. 2003). When the record reviewed in its entirety could not lead a rational fact finder to find for the nonmoving party, the moving party is entitled to judgment as a matter of law. *U.S. Fire Ins. Co. v. Vanderbilt Univ.*, 267 F.3d 465, 470 (6th Cit. 2001).

The plaintiffs contend that the government wrongfully denied their request for a refund of FICA taxes withheld because the installment payments they received under their buyout plans were not subject to the tax. They claim that the payments were made by the school district in exchange for property rights—that is, their rights as tenured teachers to continued employment absent just cause for termination—and therefore the payments were not for wages.

The Federal Insurance and Contributions Act, 26 U.S.C. § 3101, *et seq.*, "impose[s] on the income of every individual a tax [of 7.65 percent]" on all "wages" received "with respect

to employment." 26 U.S.C. § 3101(a). The proceeds of this tax support programs under the Social Security Act. *See Rowan Cos. Inc. v. United States*, 452 U.S. 247, 250 n.2 (1981). The tax imposed by FICA "shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid." 26 U.S.C. § 3102(a). The employer is also required to pay an equal amount itself as an employment tax, which is not at issue in this case. See 26 U.S.C. §§ 3102, 3111. Under FICA, "the term 'wages' means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash." *See* 26 U.S.C. § 3121(a). "[T]he term 'employment' means any service, of whatever nature, performed . . . by an employee for the person employing him." 26 U.S.C. § 3121(b).

The government argues that Sixth Circuit law commands that the phrase "remuneration for employment" "should be interpreted broadly" and must "include[] certain compensation in the employer-employee relationship for which no actual services were performed." *Gerbec v. United States*, 164 F.3d 1015, 1026 (6th Cir. 1999). *See also Social Sec. Bd. v. Nierotko*, 327 U.S. 358, 365 (1946) (concluding that the phrase "'any service . . . performed . . . for his employer'" under the Social Security Act "import[s] breadth of coverage"). However, the plaintiffs believe that *Gerbec* does not control here because the plaintiffs relinquished a tangible property interest in exchange for the payments. Rather, they say this Court should look for guidance to the Eighth Circuit decision, which, the plaintiffs suggest, deals with a materially indistinguishable claim for refunds that was sustained. *See North Dakota*, 255 F.3d at 603. There, the court stated that "[a]lthough wages and employment are read broadly in the FICA context, clearly not all payments by employers to employees constitute wages." *Ibid; see also Gerbec*, 164 F.3d at 1026. Indeed, the Supreme Court has opined that "[w]ages usually are income, but many items qualify as income and yet clearly are

not wages." *Cent. Ill. Pub. Serv. Co. v. United States*, 435 U.S. 21, 25 (1978).

In *North Dakota*, North Dakota State University (NDSU) offered an early retirement program to certain tenured faculty and high-level administrators. Under the "Early Retirement Agreement" instituted by NDSU, "the employee agreed to give up any tenure, contract, and/or other employment rights, agreed not to seek employment with a North Dakota public university or college, and agreed to give up any claim against NDSU under the Age Discrimination in Employment Act" in exchange for a negotiated "buy out" payment, which was capped at 100% of the employee's most recent annual salary. *North Dakota*, 255 F.3d at 601. Tenure at NDSU was granted to faculty members upon recommendation by NDSU to the North Dakota Board of Higher Education (Board), which made the final tenure decision. NDSU had a tenure track of six years during which time faculty members were evaluated annually. Tenure could also be granted before six years. The Board considered various factors in making tenure decisions, including scholarship in teaching and service to the institution. Once tenure was granted, the professor had the right to "continuous academic year employment in the specific program area for which the tenure was granted." *Ibid.* A tenured faculty member could be terminated only based on specified "fiscal reasons" and for "adequate cause." *Ibid.* The tenure policies also required that specific due process rights and procedures be afforded a tenured faculty before any termination.

Prior to 1991, NDSU withheld FICA taxes from the payments to those employees who had chosen to participate in the early retirement program and also paid its share of FICA taxes. During 1991, some early retirement program participants questioned NDSU's payroll department about the applicability of FICA to the payments, prompting NDSU officials to contact the Social Security Administration (SSA) about the applicability of the tax. The SSA responded with a letter

stating that the "payment to secure the release of an unexpired contract of employment" was not considered wages for Social Security purposes. As a result, NDSU stopped both withholding and paying FICA taxes on the early retirement program payments.

The IRS audited NDSU in 1995 and assessed deficiencies in FICA taxes for the years 1991 through 1994 with respect to the early retirement program payments. NDSU paid the assessment and filed for a refund with the IRS. Upon denial of the refund claim, NDSU filed a suit in federal court.

The district court determined that the retirement payments to NDSU administrators were wages subject to FICA because the administrators were "at will employees." However, the district court treated the tenured faculty members at NDSU differently because the faculty had a "recognized property interest in their tenure." *Id.* at 602. "The district court concluded that the payments to tenured faculty were made in exchange for the relinquishment of a property or contract interest rather than for compensation and as such were not subject to FICA taxation." *Ibid.*

In affirming the district court, the Eighth Circuit employed an analytical method wherein it reviewed different revenue rulings made by the Treasury Department dealing with a variety of advance or lump-sum payments made by employers to employees severing their employment relationship, and it adopted the one it found most analogous to the case at hand as the law of that circuit. The court thus looked to the Treasury Department's own determinations of whether FICA taxes were owed on severance payments made under a variety of circumstances. The first was Revenue Ruling 58-301 (1958-1 C.B.23, 1958 WL 10630), determining that FICA taxes were not payable on a lump-sum payment that terminated a five-year employment contract early. The employer and the employee agreed to cancel the contract in the second year, and the employer paid the employee a lump sum in

exchange for the employee's relinquishment of his contract rights. The IRS held that payments in exchange for contract rights are not wages under FICA. The second determination considered by the court was Revenue Ruling 74-252, where the IRS stated that payments to an employee to terminate his three-year employment contract were FICA wages. The contract gave the employer the right to terminate the contract at any time upon payment of the sum, and the IRS reasoned therefore that the payment was made pursuant to the employment contract, thereby distinguishing Revenue Ruling 58-301. The third determination, Revenue Ruling 75-44, concerned the applicability of the Railroad Retirement Tax Act (RRTA) (FICA's counterpart for railroad employees) to a lump-sum payment given to a railroad employee to buy out his seniority rights he had earned under a general employment contract. The employee enjoyed no more than at-will status, but his prior service had earned him longevity pay premiums. The IRS concluded that payment for those seniority rights constituted remuneration for past service earned and therefore the payments were wages subject to the tax.

The court noted that unlike tenured professors, the university administrators could be terminated without cause subject only to an advance notice requirement, and therefore the severance payments made to them did not purchase any contract or properly rights. *Id.* at 608. The court viewed that distinction as critical. The university professors, on the other hand, had achieved tenure that granted them lifetime appointments subject only to well-defined grounds for removal. Their tenure was a valuable right representing more than recognition for past service or performance; it was a right that had economic value to the employee, established at the outset of the tenure relationship, and protected under state law. *Id.* at 606. The court held, therefore, that payments in exchange for relinquishing tenure rights under a contract are not wages for FICA purposes.

> Under the terms of the Early Retirement Program, the tenured faculty received a negotiated amount of money in exchange for giving up their constitutional and contractual rights to tenure. In other words, they relinquished their tenure rights. They did not receive what they were entitled to under their contracts, which was continued employment absent fiscal constraints or adequate cause for termination. Rather they gave up those rights, making this case more analogous to Revenue Ruling 58-301 than to Revenue Ruling 74-252. We hold that payments made to tenured faculty under NDSU's Early Retirement Program were made in exchange for the relinquishment of their contractual and constitutionally-protected tenure rights rather than as remuneration for services to NDSU. Thus, the payments are not subject to FICA taxation.

Id. at 607.

The government argues that the tenure rights relinquished by the plaintiffs in this case are different than those in *North Dakota* because here there are no considerations of academic freedom and the tenure track for NDSU professors was more rigorous than that involved in this case. Moreover, the government contends that Sixth Circuit precedent requires a different result and points to *Gerbec v. United States, supra* in support. In that case, the Continental Can Company (Continental) "laid-off" 7,000 employees before they were eligible to vest in Continental's health and pension benefits plan. As a result, two separate classes of plaintiffs brought actions against Continental under Section 510 of the Employee Retirement Income Security Act of 1974, as amended, 29 U.S.C. § 1140, claiming that they were wrongfully discharged as part of Continental's illegal scheme to avoid paying pension benefits. Continental eventually settled the class action suits for a sum total of $415 million. The settlement was distributed and the named plaintiffs, former Continental employees, received

substantial pre-tax awards. They paid federal income and FICA taxes on the award, sought a refund that was denied, and then filed an action in federal court seeking reimbursement of the federal income tax and FICA taxes paid. Regarding the FICA taxes, the plaintiffs argued that the settlement proceeds were not "wages" or "remuneration for employment" subject to the tax. The district court granted the plaintiffs' motion for summary judgment in part finding that their award should not have been subject to the FICA tax.

On appeal, the government argued that because the settlement awards were based on an individual's age and seniority with the company, the awards were remuneration for employment and thus "wages" subject to FICA taxation. The court held that certain payments the employer made to compensate its employees for non-physical personal injuries resulting from the deprivation of civil rights were not subject to taxation. However, proceeds representing compensation for past or future wages fell within FICA's definition of "wages." *Gerbec*, 164 F.3d at 1025. In reversing that aspect of the district court's decision, the Sixth Circuit examined the Supreme Court's holding in *Social Security Board v. Nierotko*, 327 U.S. at 365. The court found that

> [t]he holding in *Nierotko* clearly supports the conclusion that awards representing a loss in wages, both back wages and future wages, that otherwise would have been paid, reflect compensation paid to the employee because of the employer-employee relationship, regardless of whether the employee actually worked during the time period in question.

Gerbec, 164 F.3d at 1026. The court then concluded by stating the following:

> Had Plaintiffs in this case actually worked for Continental during the periods for which they sought back wages and future wages lost as a result of the firing, the

> wages indisputably would have been subject to FICA taxation. We conclude that it would be improper to exempt Plaintiffs from mandatory FICA taxes merely because they were not employees of Continental at the time the payments were made and because the payments were not in return for actual services performed. *Cf.* 26 C.F.R. § 31.3121(a)-(1)(i) ("[r]emuneration for employment . . . constitutes wages even though at the time paid the relationship of the employer and employee no longer exists between the person in whose employ the services were performed and the individual who performed them"). Therefore, any damages attributable to wages they would have received had they not been wrongly terminated should also be subject to the FICA taxes they would have paid on those wages had they not been wrongly terminated. Any other result would run contrary to the purpose of the FICA system.

Id. at 1026-27.

It is the language quoted above that the government contends is the law of the Circuit that controls the decision in this case.

The government also contends that the *North Dakota* court was incorrect when it concluded that payments that arose from the employment relationship should not be considered as wages. It urges this Court to follow the reasoning of the Court of Federal Claims in *CSX Corp. v. United States*, 52 Fed. Cl. 208 (2002), which rejected the holding in *North Dakota*. In that case, the plaintiff, a railroad company, was forced to implement major reductions in its work force between 1984 and 1990. As part of its work force reduction, the plaintiff made bi-weekly, monthly, and lump-sum payments to various employees for ending their employment as required by certain regulatory rulings and collective bargaining agreements. The plaintiff paid its share of the FICA tax and the RRTA tax and withheld and remitted the employee's

share of those amounts on the lump-sum payments. However, the plaintiff later filed for a refund of the FICA and RRTA taxes claiming that the payments in question were "supplemental employment compensation benefits" not subject to the employment taxes. After the IRS denied the refund claim, the plaintiff filed suit in the Court of Federal Claims seeking a determination that the reduction-in-force payments constitute neither wages nor compensation for purposes of imposing federal employment tax. In rejecting the plaintiffs assertion that the payments were not subject to FICA, the court held the following:

> We think plaintiffs are applying the definition of wages too narrowly. As has been repeated several times in this opinion, the term "wages" is defined as "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash." 26 U.S.C. § 3121(a). Pursuant to this definition then, the value of the benefits and protections that each employee held in his or her position—rights to vacation pay, sick pay, layoff pay, and seniority—constituted part of the employee's total compensation package and, hence, constituted wages. Therefore, when these job-related benefits are relinquished in favor of a lump-sum payment, the transaction simply amounts to a redemption, paid in cash, of wage amounts previously paid in kind. Because a separation payment is simply an exchange of equivalent values, what were wages at the start remain wages at the end.
>
> Plaintiffs insist, however, that payments received in exchange for the release of employment rights are not wages subject to employment taxes. In support of this position, plaintiffs rely on *North Dakota State Univ. v. United States*, 255 F.3d 599 (8th Cir.2001), a case holding that severance payments made to tenured faculty members in exchange for their early retirement did not

constitute remuneration for services and, hence, did not constitute wages. The basis for this holding was the court's conclusion that the relinquishment of tenure represented the relinquishment of rights to "continued employment absent fiscal constraints or adequate cause for termination." *Id.* at 607. Plaintiffs now draw on this same reasoning, saying that the job protection and seniority rights relinquished here are, like tenure, rights to continued employment. Hence, they argue, the separation payments received in exchange for the relinquishment of these rights are not wages.

Although this court is not bound by a decision of the Eighth Circuit, it recognizes that, as a trial court, it should endeavor to follow the teaching of higher authority whenever it can reasonably do so. In this instance, however, such adherence is not possible—at least not without reversing course on what we have thus far decided. This court can see no basis upon which to distinguish between the tenure rights considered in *North Dakota* and the contract rights at issue here. In each case, the surrender of these rights in return for a cash payment represents the surrender of enforceable rights to future earnings in return for a present sum. Because the rights being surrendered are integral to the employment relationship—they are part and parcel of the job protections and job benefits to which the employee may lay claim in return for his or her labor—they must be considered wages. And whether accrued over the term of the employment relationship or redeemed at present value, these rights represent remuneration for services and, hence, are wages.

CSX Corp., 52 Fed. Cl. at 220-221.

Perhaps the simplest course under Sixth Circuit precedent would be to hold that any payments arising from the employer-employee relationship constitutes "wages" under 26

U.S.C. § 3101. However, that rule would contradict the Supreme Court's holding in *Illinois Central States* that payments made by an employer to its employees to reimburse them for work-related lunch expenses were not subject to FICA. 435 U.S. at 25. The government conceded at oral argument that this case stood in the way of a blanket rule requiring all payments made by the employer to an employee to be deemed wages under FICA. Moreover, the rule articulated in *Gerbec* was not nearly as absolute as the government contends. The court there said that the statutory definition of wages found in FICA "includes *certain* compensation in the employer-employee relationship for which no actual services were performed." *Gerbec*, 164 F.3d at 1026 (emphasis added). An alternate rule would be to apply FICA only to those payments made by an employer to employees in exchange for actual work or services, but that approach runs afoul of Sixth Circuit precedent. Furthermore, the payments in this case were not for services, past, present or future. Rather, they were made in exchange for the employees' relinquishment of the right to exchange services for wages in the future. They were not payments for work; they were payments not to work.

Nor does the Court agree with the reasoning of *CSX Corp.* that the surrender of contract rights to work in exchange for cash must be considered as wages under FICA. That ruling does not account for the fact acknowledged by the Sixth Circuit in *Gerbec* that compensation by an employer for the deprivation of certain rights constitutes neither income nor wages for federal tax purposes, including FICA, *see Gerbec*, 164 F.3d at 1025, and ignores the Treasury Department's Revenue Ruling 58-301 determining that consideration for an employer's purchase of contract rights from an employee is not "wages" subject to FICA. The Sixth Circuit has held that revenue rulings by the Treasury Department, although not carrying the force of agency regulations under *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467

U.S. 837 (1984), nonetheless are entitled to "substantial deference." *Aeroquip-Vickers, Inc, v. C.I.R.*, 347 F.3d 173, 180-81 (6th Cir. 2003) (citing *United States v. Cleveland Indians Baseball Co.*, 532 U.S. 200, 220 (2001) (holding that "[i]n the context of tax cases, the IRS's reasonable interpretations of its own regulations and procedures are entitled to particular deference"). That is because "[r]evenue rulings . . . serve as 'official interpretation[s]' by the IRS of the tax laws," *Id.* at 181.

The Court believes that the principled method of distinguishing "wages" from other employer payments articulated by the Treasury Department in its revenue rulings, fully discussed by the *North Dakota* court, is to focus on the purpose of the payments. Payments for past or future service, or in recognition of past performance, are wages subject to the tax. Payments for other purposes are not. Or in the words of the *Gerbec* court, payments "attributable to wages [workers] would have received had they not been wrongly terminated should also be subject to the FICA taxes" irrespective of whether the worker was still employed at the time the payment was made. *Gerbec*, 164 F.3d at 1027. Compensation for the deprivation of other rights are not subject to taxation. *Id.* at 1025.

The government argues that the payments made by the school districts to the plaintiffs in exchange for relinquishing tenure rights in reality are payments in lieu of future wages, and therefore are more analogous to the compensation paid to the employee in Revenue Ruling 74-252 or the railroad worker in Revenue Ruling 75-44. In those cases, however, the employees were employed either at will or subject to a contractual provision that fixed a sum for early termination; there was no contractual or statutory right to continued employment. In contrast, an examination of tenure under Michigan law discloses direct parallels to the nature of the tenure discussed in *North Dakota*.

Courts in Michigan consider tenure for public school teachers to be a property right. *See Tomiak v. Hamtramck School District*, 426 Mich. 678, 700, 397 N.W.2d 770, 779-80 (1986) (stating that "[a]lthough . . . the teacher tenure act does not require a full evidentiary hearing before removing an abandoning teacher's name from the recall list, there remains consideration of plaintiff's constitutional right to due process of law. Because continued employment *is a protected property interest*, a termination of that interest requires conformity to the requirements of due process under the Fourteenth Amendment and Const.1963, art. 1, § 17.") (emphasis added); *Detroit Bd. of Educ. v. Parks*, 98 Mich. App. 22, 42, 296 N.W.2d 815, 825 (1980) (holding that tenured teachers in Michigan have a protected property interest in their employment which entitles teachers to notice and an opportunity to be heard prior to being discharge for failure to pay agency shop fees). A similar analogy has been drawn to civil service employees and their property interests in employment. *See State Employees Ass'n v. Department of Mental Health*, 421 Mich. 152, 160-161, 365 N.W.2d 93, 97 (1984) ("The guarantee of job tenure absent just cause for dismissal under the Michigan civil service system creates a property right for public employees which the state may only take away in accordance with due process.") (citing *Board of Regents of State Colleges v. Roth*, 408 U.S. 564 (1972)).

Tenure is itself a relationship between a teacher and her school district, but it arises by operation of state law. Under Michigan's Teacher Tenure Act, Mich. Comp. Laws § 38.71, *et. seq.*, a teacher first hired by a school district is subject to "a probationary period during his or her first 4 full school years of employment." Mich. Comp. Laws § 38.81. "Teacher" is defined in the Act as "a certificated individual employed for a full school year by any board of education or controlling board." Mich. Comp. Laws § 38.71. "The term 'certificated' means holding a valid teaching certificate, as defined by the state board of education." Mich. Comp. Laws § 38.72. At

least sixty days before the close of each school year the controlling board, which is defined in the Act as any board "having the care, management, or control over public school districts and public educational institutions," Mich. Comp. Laws § 38.73, is required to provide the probationary teacher with a "definite written statement as to whether or not his work has been satisfactory." Mich. Comp. Laws § 38.83. Failure to submit a written statement is considered in the Act as conclusive evidence that the teacher's work is satisfactory. *Ibid.* The Act also provides that "[a]ny probationary teacher or teacher not on continuing contract shall be employed for the ensuing year unless notified in writing at least 60 days before the close of the school year that his services will be discontinued." *Ibid.* Finally, the Act provides that the "controlling board of the probationary teacher's employing school, district shall ensure that the teacher is provided with an individualized development plan developed by appropriate administrative personnel in consultation with the individual teacher and that the teacher is provided with at least an annual year-end performance evaluation each year during the teacher's probationary period." Mich. Comp. Laws § 38.83a. Failure of a school district to provide a probationary teacher with a development plan or a performance evaluation "is conclusive evidence that the teacher's performance for that school year was satisfactory." *Ibid.*

After the satisfactory completion of the probationary period, the Act states that "a teacher shall be employed continuously by the controlling board under which the probationary period has been completed, and shall not be dismissed or demoted except as specified" in the Act. Mich. Comp. Laws § 38.91. The Act requires that the

> controlling board of the school district employing a teacher on continuing tenure shall ensure that the teacher is provided with a performance evaluation at least once every 3 years and, if the teacher has received a less than

> satisfactory performance evaluation, the school district shall provide the teacher with an individualized development plan developed by appropriate administrative personnel in consultation with the individual teacher.

Mich. Comp. Laws § 38.93(1). Failure of a school district to comply with Section 38.93(1) "is conclusive evidence that the teacher's performance for that period was satisfactory." Mich. Comp. Laws § 38.93(2).

The Act allows for "discharge" or "demotion" of a teacher on continuing tenure, but "only for reasonable and just cause." Mich. Comp. Laws § 38.101. Demotion is defined in the Act as a "means to reduce compensation for a particular school year by more than an amount equivalent to 3 days' compensation or to transfer to a position carrying a lower salary." Mich. Comp. Laws § 38.74. The Act states that "all charges against a teacher shall be made in writing" and "a copy of the charges shall be provided to the teacher." Mich. Comp. Laws § 38.102.

> The charges shall specify a proposed outcome of either discharge or a specific demotion of the teacher. The controlling board shall decide whether or not to proceed upon the charges, or may modify the charges and decide to proceed upon the charges as modified, not later than 10 days after the charges are filed with the controlling board. A decision to proceed upon the charges shall not be made except by a majority vote of the controlling board and shall be reduced to writing. The controlling board, if it decides to proceed upon the charges, shall furnish the teacher not later than 5 days after deciding to proceed upon the charges with the written decision to proceed upon the charges, a written statement of the charges and a statement of the teacher's rights under this article.

Ibid. The Act also provides that the a "teacher on continuing tenure may contest the controlling board's decision to pro-

ceed upon the charges against the teacher by filing a claim of appeal with the tenure commission and serving a copy of the claim of appeal on the controlling board." Mich. Comp. Laws § 38.104.

The rights granted by statute are the rights the plaintiffs relinquished in exchange for the payments at issue in this case. The illegal deprivation of those rights would have given rise to a cause of action for damages, and those damages recovered would not be taxable under the Sixth Circuit's reasoning in *Gerbec*. Likewise, the payments made for the sale of those rights would not constitute remuneration for employment, just as the payment made to buy out the remaining years of the five-year contract in Revenue Ruling 58-301 was not "wages" subject to FICA.

The Court finds, therefore, that the payments made to the public school teachers in exchange for their tenure rights, that is, the right to continued employment absent just cause for termination, pursuant to the early retirement incentive plans outlined earlier, were not "wages" within the meaning of FICA, 26 U.S.C. § 3121(a). The tax should not have been assessed on those payments, and the plaintiff's claim for a refund should have been allowed.

III.

The Court concludes that the plaintiffs' claims for refunds of FICA taxes withheld and remitted to the government are valid and should have been allowed. Accordingly, it is ORDERED that the plaintiff's motion fort summary judgment [dkt # 48] is GRANTED.

It is further ORDERED that the defendant's motion for summary judgment [dkt # 46] is DENIED.

It is further ORDERED that the parties shall present an agreed form of judgment in compliance with FED. R. CIV. P. 23(c)(3) on or before August 16, 2004. The plaintiffs' counsel

shall submit supporting memoranda and affidavits in support of their request for attorney fees on or before August 16, 2004, to which the defendant may respond on or before August 30, 2004.

/s/ David M. Lawson
David M. Lawson
United States District Judge

Dated: August 2, 2004

Copies sent to: Suzanne Krumholz Clark, Esquire
James D. Ponscheck, Esquire
Thomas P. Cole, Esquire

APPENDIX C

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

Case No. 5:02-CV-176
HON. GORDON J. QUIST

DONALD F. APPOLONI, SR., RUSSELL C. BERGEMANN, and SANDRA ENGEL, individually and as representatives of all similarly-situated individuals.
Plaintiffs,

v.

UNITED STATES OF AMERICA,
Defendant.

OPINION

In this class action, Plaintiffs and class representatives, Donald F. Appoloni, Sr., Russell C. Bergemann, and Sandra Engel, are retired public school teachers who allege that they exchanged their property rights of tenure under Michigan law in exchange for payments of money by their employer. Plaintiffs' employer withheld taxes on those payments under the Federal Insurance Contributions Act ("FICA"), and Plaintiffs filed claims for refunds of the FICA tax. On November 21, 2002, after the Internal Revenue Service ("IRS") denied Plaintiffs' administrative claims, Plaintiffs filed this action on behalf of themselves and all others similarly situated in the Western District of Michigan against the United States ("Government") for refund of the FICA taxes assessed on the payments they received in exchange for their property rights. By Order dated June 18, 2003, as amended by Order dated October 16, 2003, the Court granted Plaintiffs' motion for class certification and certified a class pursuant to Fed. R.

Civ. P. 23(b)(3). Now before the Court are the parties' cross motions for summary judgment.

I. *Facts*

Plaintiffs were formerly employed as public school teachers by the Dowagiac Union School District (the "District") and were all tenured employees under the Michigan Teachers' Tenure Act (the "Tenure Act"), M.C.L. §§ 38.71 to 38.191. Under the Tenure Act, a teacher is granted tenure after satisfactorily completing a four-year (formerly two-year) probationary period of employment. M.C.L. § 38.81. A teacher who has received tenure may be discharged or demoted "only for reasonable and just cause and only as provided in [the Tenure Act]." M.C.L. § 38.101. Plaintiff Appoloni obtained tenure in 1990, Plaintiff Bergemann obtained tenure in 1970, and Plaintiff Engel obtained tenure in 1975.

In 2001, the District offered certain teachers a monetary incentive to take early retirement under the Employee Severance Plan ("ESP"). Eligible teachers who elected early retirement under the ESP would receive one year of salary (up to $53,021) to be paid in monthly installments over five years. The ESP was incorporated into the Master Contract Agreement between the District and the Van Buren County Education Association and the Dowagiac Education Association. The purpose of the ESP was "to help prevent teacher layoffs and to lessen the Board's economic responsibility in the area of staffing." (Master Contract Agreement at 45, Cole Decl. Ex. 1.) The ESP was entirely voluntary, was available to only the first thirty teachers who applied, and required a minimum of fifteen applicants in order to trigger the District's obligations under the ESP. To be eligible, a teacher had to have ten years of service with the District and be at the top of the pay scale. In addition, an interested teacher was required to declare his or her intention to participate in the ESP by January 9, 2001, and to continue teaching until no later than June 2001. Applicants were also required to complete an Indica-

tion of Interest Form, a Release and Waiver of Claims Agreement, a Notice of Enrollment, and a Designation of Beneficiary Form. (ESP Plan Description ¶ 5, Cole Decl. Ex.2.) The Release and Waiver of Claims Agreement contained a broad waiver, pursuant to which the employee waived all claims arising out of employment with the District, including claims that the employee was improperly forced to resign, claims or grievances based upon breach of the Master Contract Agreement, age discrimination claims, claims under state and federal civil rights laws, and claims under the Tenure Act. (Release & Waiver of Claims Agreement ¶ 3, Pl.'s Br. Supp. Mot. Ex. E.)

Plaintiffs were qualified for the ESP, and their applications were accepted by the District. Plaintiffs Appoloni and Engel retired in June 2001 and Plaintiff Bergemann retired in August 2001. Plaintiffs began receiving their ESP payments upon retirement. The District withheld FICA taxes from Plaintiffs' ESP payments. Each Plaintiff filed a claim for refund of the employee's portion of the FICA taxes on the basis that the ESP payments are not wages but instead are payments in exchange for Plaintiffs' property rights. Plaintiffs filed this action after the IRS denied their claims for a refund.

II. Summary Judgment Standard

Summary judgment is appropriate if there is no genuine issue as to any material fact and the moving party is entitled to a judgment as a matter of law. Fed. R. Civ. P. 56. Material facts are facts which are defined by substantive law and are necessary to apply the law. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248, 106 S. Ct. 2505, 2510 (1986). A dispute is genuine if a reasonable jury could return judgment for the non-moving party. *Id.*

The court must draw all inferences in a light most favorable to the non-moving party, but may grant summary judgment when "the record taken as a whole could not lead a

rational trier of fact to find for the non-moving party." *Agristor Financial Corp. v. Van Sickle*, 967 F.2d 233, 236 (6th Cir. 1992) (quoting *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 587, 106 S. Ct. 1348, 1356 (1986)).

III. *Discussion*

The sole issue presented in this case is whether the ESP payments Plaintiffs are receiving are wages for purposes of FICA. Plaintiffs contend that the ESP payments are not wages but instead constitute payment for Plaintiffs' surrender of their tenure rights. Plaintiffs rely heavily upon the Eighth Circuit's decision in *North Dakota State University v. United States*, 255 F.3d 599 (8th Cir. 2001). The Government contends that the ESP payments are wages subject to FICA tax because regardless of whether the payments are for a property right, the payments are for a right that arose out of the employment relationship. The Government contends that the Sixth Circuit's decision in *Gerbec v. United States*, 164 F.3d 1015 (6th Cir. 1999), is controlling in this case. Both parties agree that Plaintiffs' right to tenure is a protected property right subject to due process protections. *See Tomiak v. Hamtramck Sch. Dist.*, 426 Mich. 678, 700, 397 N.W.2d 770, 780 (1986).[1]

FICA is a tax imposed upon the wages of employees to fund Social Security programs such as Old-age, Survivors, and Disability Insurance, as well as Medicare Insurance. 26 U.S.C. § 3101; *see Rowan Cos., Inc. v. United States*, 452 U.S. 247, 249 n.2, 101 S. Ct. 2288, 2290 n.2 (1981). The employer and the employee pay an equal portion of the tax. 26 U.S.C. §§ 3101, 3111. The employee's share of the tax is

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[1] Property interests protected by the Due Process Clause of the Fourteenth Amendment to the United States Constitution do not arise under the constitution but rather "are created and defined by independent sources, such as state law." *Hamilton v. Myers*, 281 F.3d 520, 529 (6th Cir. 2002).

collected by the employer through deductions from the employee's wages. 26 U.S.C. § 3102. FICA defines "wages" as "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash," subject to certain exemptions not relevant here. 26 U.S.C. § 3121(a). The term "employment" is defined as "any service, of whatever nature, performed . . . by an employee for the person employing him." 26 U.S.C. § 3121(b).

The Supreme Court interprets the phrase "remuneration for employment" broadly. *Soc. Sec. Bd. v. Nierotko*, 327 U.S. 358, 365, 66 S. Ct. 637, 641 (1946); *see also Gerbec v. United States*, 164 F.3d 1015, 1026 (6th Cir. 1999) (stating that "[t]he phrase 'remuneration for employment' as it appears in § 3121 should be interpreted broadly"). Similarly, Treasury Regulations define "wages" broadly. Regardless of the name given to the payment, any remuneration for employment constitutes "wages." 26 C.F.R. § 31.3121(a)-1(c). Also, "the basis upon which the remuneration is paid is immaterial in determining whether the remuneration constitutes wages." 26 C.F.R. § 31.3121(a)-1(d). However, the Supreme Court has said that while all wages under FICA are "income.'" for purposes of income-tax withholding, the converse is not true, because "'wages' is a narrower concept than 'income.'" *Rowan Cos.*, 452 U.S. at 254, 101 S. Ct. at 2293 (citing *Cent. Ill. Pub. Serv. Co. v. United States*, 435 U.S. 21, 25, 98 S. Ct. 917, 919 (1978)). Thus, "'[w]ages usually are income, but many items qualify as income and yet clearly are not wages.'" *Rowan Cos.*, 452 U.S. at 254, 101 S. Ct. at 2293 (quoting *Cent. Ill. Pub. Serv. Co.*, 435 U.S. at 25, 98 S. Ct. at 919).[2]

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[2] Plaintiffs argued in their brief in opposition to the Government's motion and again at oral argument that the *Central Illinois* case, and not *Nierotko*, is the governing authority on what constitutes wages for employment tax purposes. Plaintiffs further argue that in *Central Illinois* the Court refused to extend *Nierotko's* rationale for breadth of coverage from

The Sixth Circuit addressed the issue of wages for purposes of FICA in *Gerbec v. United States*, 164 F.3d 1015 (6th Cir. 1999). There, the plaintiffs were part of a class of employees who received settlement payments in a class action against their former employer. The plaintiffs in the class action alleged that their employer violated Section 510 of the Employment Retirement Income Security Act of 1974 by discharging a large number of workers shortly before they were eligible to vest in the employer's pension and health plans. The funds were distributed to class members based upon a Basic Award component, which was designed to compensate for the loss of dignity resulting from the alleged discrimination based upon age and years of service, and an Earnings Impairment Additur component, which was designed to compensate for loss in earnings capacity and to approximate long-term loss in employment prospects. The issues before the court in *Gerbec* were whether the plaintiffs' settlement awards were exempt from federal income tax under 26 U.S.C. § 104(a)(2), which at that time excluded amounts of damages "'received . . . on account of personal injuries or sickness,'" *id.* at 1018 (quoting 26 U.S.C. § 104(a)(2)), and whether their settlement awards were subject to FICA tax. With regard to

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the social security benefits area to the employment tax area. The Court disagrees with Plaintiffs' assessment of *Central Illinois*. The issue in *Central Illinois* was whether an employer was required to withhold federal income tax on payments it made to its employees for reimbursement of lunch expenses. The Court held that the employer was not required to do so because there was no regulation requiring withholding on such payments and prior cases had maintained the distinction between "wages" and "income." *Central Ill.*, 435 U.S. at 30-32, 98 S. Ct. at 922-23. Essentially, the Court refused to equate "wages" with "income" for purposes of income tax withholding because "wages" is a narrower concept than "income." The Court did not, as Plaintiffs suggest, reject *Nierotko's* observation that the definition of "wages," "employment," and "any service" are worded so as to "import breadth of coverage" with regard to the determination of whether payments made in the employment context are subject to employment tax. *Nierotko*, 327 U.S. at 365, 66 S. Ct. at 641.

the income tax issue, the court held that the compensatory damages aspect of the settlement agreement fell within the exclusion under § 104(a)(2) but that non-tort amounts for back pay and future lost wages would be subject to taxation. *Id.* at 1023-25. With regard to the FICA issue, the court held that amounts for back pay and future lost wages were wages subject to FICA taxation. *Id.* at 1026. The court reached this conclusion even though the plaintiffs did not actually perform services for the payments they received. Noting that "[t]he phrase 'remuneration for employment' as it appears in § 3121 should be interpreted broadly," the court concluded that "'remuneration for employment' includes certain compensation in the employer-employee relationship for which no actual services were performed." *Id.* at 1026 (footnote omitted). As support for its conclusion, the court cited *Social Security Board v. Nierotko*, 327 U.S. 358, 66 S. Ct. 637 (1946), in which the Supreme Court held that an award of back pay qualified as wages under the Social Security Act of 1935 for purposes of crediting the worker's Old Age and Survivor's Insurance account. The Supreme Court reasoned that "service" as used in the Social Security Act "means not only work actually done but the entire employer-employee relationship for which compensation is paid to the employee by the employer." *Nierotko*, 327 U.S. at 365-66, 66 S. Ct. at 637. Based upon *Nierotko*, the *Gerbec* court concluded "that awards representing a loss in wages, both back wages and future wages, that otherwise would have been paid, reflect compensation paid to the employee because of the employer-employee relationship, regardless of whether the employee actually worked during the time period in question." *Gerbec*, 164 F.3d at 1026. The court noted that those amounts would have been subject to FICA taxation if the plaintiffs had actually worked for the employer during the periods covered by the back pay and future wage loss components of the award. *Id.*

In *North Dakota State University v. United States*, 255 F.3d 599 (8th Cir. 2001) ("*NDSU*"), the Eighth Circuit held in a case of first impression at the appellate level that payments made to tenured faculty members in exchange for their tenure rights were not wages subject to FICA taxation. The court reasoned that the payments were for relinquishment of contractual and constitutionally-protected rights and not as remuneration for services to the university. The tenure system in that case provided that tenure could be granted to a faculty member after successful completion of a six-year probationary period. In certain cases tenure could be granted earlier or even perhaps upon an employee's hire. However, tenure was not automatic and required the employee to demonstrate a certain level of academic achievement, such as scholarship in teaching, contribution to a discipline or profession through research, other scholarly or professional activities, and service to the university and society. *Id.* at 601. The court pointed out that in contrast to seniority rights, which are attained solely through completion of service, a professor could receive tenure only by demonstrating qualities that merited tenure. *Id.* at 603. The court summed up its analysis as follows:

> Under the terms of the Early Retirement Program, the tenured faculty received a negotiated amount of money in exchange for giving up their constitutional and contractual rights to tenure. In other words, they relinquished their tenure rights. They did not receive what they were entitled to under their contracts, which was continued employment absent fiscal constraints or adequate cause for termination. Rather they gave up those rights . . . in exchange for the relinquishment of their contractual and constitutionally-protected tenure rights rather than as remuneration for services to NDSU.

Id. at 307.

As part of its analysis in *NDSU,* the court considered three Revenue Rulings addressing whether lump-sum payments to employees constituted wages subject to taxation under FICA or other similar enactments.[3] In Revenue Ruling 58-301, the taxpayer was employed under a written contract with a five-year term. In the second year of the contract, the taxpayer and his employer agreed to cancel the remaining term of the contract, and the taxpayer agreed to accept a lump-sum payment as consideration for the cancellation of his contract rights. The majority of the ruling was devoted to the issue of whether the payment constituted a capital gain or was ordinary income. After concluding that the payment was ordinary income, the IRS concluded in one sentence, without explanation, that the lump sum payment was not subject to FICA tax. *See* Rev. Rul. 58-301, 1958-1 C.B. 23, 1958 WL 10630 (1958). In Revenue Ruling 74-252, the employee had a three-year employment contract which permitted the employer to terminate the employment relationship at any time provided the employer paid the employee an amount equal to six months salary. The employer terminated the contract and began making payments. Citing regulations pertaining to income tax withholding, the IRS concluded that the payment was wages under both FICA and the Federal Unemployment Tax Act. The IRS distinguished the payments from the lump-sum payment in Revenue Ruling 58-301 on the basis that the instant payments were made by the employer upon the employee's involuntary separation and were in the nature of

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[3] The Sixth Circuit has held that a revenue ruling is not entitled to the same degree of deference accorded a statute or a Treasury Regulation but that some deference is appropriate depending upon "'the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.'" *Aeroquip-Vickers, Inc. v. Comm'r,* 347 F.3d 173, 181 (6th Cir. 2003) (quoting *United States v. Mead Corp.*, 533 U.S. 218, 228, 121 S. Ct. 2164, 2172 (2001) (quoting *Skidmore v. Swift & Co.*, 323 U.S. 134, 140, 65 S. Ct. 161, 164 (1944)).

dismissal payments, whereas the payment in Revenue Ruling 58-301 was made as consideration for the employee's relinquishment of his interest in his employment contract—an interest in the nature of property. *See* Rev. Rul. 74-252, 1974-1 C.B. 287, 1974 WL 34867 (1974). Finally, in Revenue Ruling 75-44, a railroad employee had acquired rights to security in his employment and to additional pay or other recognition for longevity based upon his past service under a general contract of employment with the railroad. The employee entered into an agreement with his employer to perform a different type of work and to refrain from asserting the employment rights he had previously acquired in exchange for a lump sum payment from the employer. The IRS determined that the lump sum payment was wages for purposes of income tax withholding because the employee had acquired his relinquished employment rights through his prior performance of services to the employer. The IRS also distinguished the payment from the payment in Revenue Ruling 58-301, noting that the present case did not involve the cancellation of an employment contract which, from the outset, bound the parties to a specified period of time. *See* Rev. Rul. 75-44, 1975-1 C.B. 15, 1975 WL 34658 (1975). The *NDSU* court determined that the facts in that case were most analogous to those in Revenue Ruling 58-301 because the faculty members received the payments in exchange for relinquishing their contractual and constitutionally protected tenure rights. *NDSU*, 255 F.3d at 607.

NDSU appears to be the lone authority regarding the specific issue of whether a payment received in exchange for tenure rights constitutes wages. However, one court, finding *NDSU* factually indistinguishable with regard to the type of payment at issue, has declined to follow *NDSU*. *See CSX Corp. v. United States*, 52 Fed. Cl. 208 (2002). In *CSX*, the plaintiff railroads made substantial organizational changes to effectuate major reductions in force which resulted in a reduction of approximately twenty thousand railroad employ-

ees. The plaintiffs accomplished the reductions in force through several means, including permanent separations of some employees. All affected employees received some form of payment, and employees who ended their employment received monthly or lump sum payments. The plaintiffs paid the employer's share of FICA and other employment taxes and withheld and remitted the employees' shares of those taxes and subsequently filed claims for refunds. The majority of the court's opinion in *CSX* was devoted to the plaintiffs' primary argument, not relevant here, that the payments were "supplemental unemployment compensation benefits" and therefore were not wages subject to FICA. After concluding that most of the payments did not qualify as supplemental unemployment compensation benefits, the court turned to the plaintiffs' last argument, which was that the separation payments did not constitute wages because they did not represent compensation for services. The plaintiffs argued that, among other things, the separation payments were not wages because the payments constituted a buy-out of the plaintiffs' contractual employment rights. The court found that the plaintiffs' arguments construed the definition of wages too narrowly. *Id.* at 220. The court observed that the value of the benefits the plaintiffs held in their positions, including rights to vacation pay, sick pay, layoff pay, and seniority, were part of the plaintiffs' entire employment package and therefore were wages. *Id.* at 221. Thus, the court found that the plaintiffs' exchange of those rights for a lump sum payment "simply amount[ed] to a redemption, paid in cash, of wage amounts previously paid in kind. Because a separation payment is simply an exchange of equivalent values, what were wages at the start remain wages at the end." *Id.* The court declined to apply *NDSU,* even though it found no basis to distinguish between the tenure rights at issue in *NDSU* and the contract rights in the case before it—in both cases the employees surrendered "enforceable rights to future earnings in return for a present sum." *Id.* The court concluded that such pay-

ments must be considered wages because the rights surrendered were "part and parcel of the job protections and job benefits to which the employee may lay claim in return for his or her labor." *Id.*

Based upon the foregoing discussion, the Court determines the issue of whether the ESP payments were wages by answering the following questions: (1) Did Plaintiffs receive the payments because of their employment relationship with the District?; and (2) Were Plaintiffs' tenure rights a benefit Plaintiffs earned through prior service to the District? The answer to the first question is yes. Even though Plaintiffs did not actually perform any services for the District in exchange for the payments, *Nierotko* and *Gerbec* both teach that a payment may be "remuneration for employment" even where no actual services were performed. The purpose of the ESP was to provide the District a mechanism for controlling its fiscal outlay for staffing by encouraging a group of teachers with high seniority and at the top of the pay scale to terminate their employment relationship with the District. In exchange for the payments, Plaintiffs gave up their rights to continued employment with the District, as well as any other incidental benefits arising out of their employment relationship with the District. As in *Gerbec*, the payments to Plaintiffs represent at least part of the compensation Plaintiffs would have otherwise received had they continued to work for the District. *See Greenwald v. United States*, No. 98 Civ. 3439 (DC), 2000 U.S. Dist. LEXIS 102, at *10 (S.D.N.Y. Jan. 6, 2000) (finding that a lump sum payment in exchange for the employee's relinquishment of future salary and bonus was a "substitute for future 'wages'"). Further support for this conclusion is found in the releases that Plaintiffs were required to sign in order to participate in the program. The releases covered a broad spectrum of potential claims arising out of the employment context. As Plaintiffs note, there is no evidence that Plaintiffs had any claims to release other than claims for payment for their tenure rights. However, the absence of

other claims covered by the release does not undermine the conclusion that the payments were made to compensate for the employer-employee relationship. *See Abrahamsen v. United States*, 228 F.3d 1360, 1364-65 (Fed. Cir. 2000). "Because the rights . . . surrendered [were] integral to the employment relationship—they are part and parcel of the job protections and job benefits to which the employee may claim in return for his or her labor-they must be considered wages." *CSX Corp.*, 52 Fed. Cl. at 221.

With regard to the second question, whether Plaintiffs acquired their tenure rights as a result of past service for the District, the answer is also yes. The rights Plaintiffs possessed under the Tenure Act essentially boil down to the right to continued just cause employment, albeit in this case a right subject to due process protections. Plaintiffs acquired this right through performance of services for the District for the specified probationary period. After the successful completion of the probationary period, Plaintiffs received their statutory right to continued just cause employment. The circumstances in this case are thus more akin to those in Revenue Ruling 75-44 than to those in Revenue Ruling 58-301, because Plaintiffs acquired their rights through past performance of services, as in the former case, rather than at the beginning of the employment relationship, as in the latter case. "A payment arising from services rendered in the past clearly constitutes 'wages.'" *Greenwald*, 2000 U.S. Dist. LEXIS 102, at *11 (citing *Nierotko*). Therefore, the Court concludes that the ESP payments Plaintiffs received in exchange for their tenure rights were wages subject to FICA taxation.

Plaintiffs argue that tenure is much more than recognition for past services, as was the case in *NDSU*. Plaintiffs point out that in order to obtain tenure, a teacher must not only meet all of the requirements imposed by the State of Michigan, but must also meet any standards or requirements

imposed by the local school board. One example Plaintiffs cite is the requirement that they maintain their teaching certificates, including the continuing education requirement. Plaintiffs also contend that the purposes of tenure under the Tenure Act, "to maintain an adequate and competent teaching staff, free from political and personal interference and to protect teachers from arbitrary and capricious employment practices of school boards," *Tomiak*, 426 Mich at 686-87, 397 N.W.2d at 774 (citations omitted), are almost identical to the purposes of the tenure at issue in *NDSU*. While all of that may be true, the fact remains that under the Tenure Act, successful completion of the probationary period, i.e., past service, is an important, if not the primary, requirement for obtaining tenure.[4] In fact, in contrast to the tenure requirements in *NDSU*, the grant of tenure in this case is complete and automatic upon a teacher's successful completion of the probation; there is no separate application process. *See* M.C.L. § 38.83 (providing that the controlling school board's failure to provide the probationary teacher with a written statement regarding whether the teacher's work is satisfactory "shall be considered as conclusive evidence that the teacher's work is satisfactory"). Thus, regardless of whatever requirements may be imposed upon teachers after they receive tenure, the granting of tenure remains tied exclusively to the employee's performance of past satisfactory services. The Court finds *NDSU* distinguishable from the instant case, and to the extent that it is not, the Court declines to follow *NDSU*.

Plaintiffs also make much of the fact that their tenure rights are property rights. Yet, they fail to cite any basis for treating their payments differently from payments made for mere seniority rights not subject to due process protections with

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[4] At oral argument Plaintiffs' counsel stressed that tenure rights are granted by the State of Michigan rather than by the individual school district. Even so, the fact remains that tenure rights are granted in significant part *because* of the employee's past service to the employer.

regard to the issue of FICA tax. While Plaintiffs' tenure rights had value to Plaintiffs, they had value only to the extent that Plaintiff continued to exercise them in the context of their employment relationship with the District. In this regard, a purchase of Plaintiffs' tenure rights cannot be distinguished from the purchase of other similar rights, such as seniority rights, at least with regard to the issue of whether the payment for such rights constitutes wages.

IV. *Conclusion*

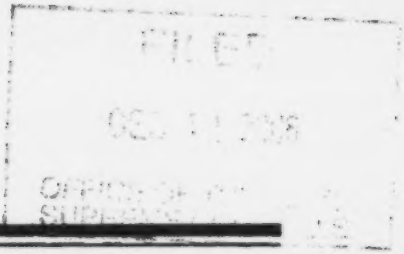
For the foregoing reasons, the Court concludes that the payments Plaintiffs received in exchange for their tenure rights are wages subject to FICA taxation. Accordingly, the Court will grant the Government's motion for summary judgment and deny Plaintiffs' motion for summary judgment.

An Order consistent with this Opinion will be entered.

Dated: July 21, 2004.

/s/ Gordon J. Quist
GORDON J. QUIST
UNITED STATES DISTRICT JUDGE

(2)



No. 06-334

In the Supreme Court of the United States

DONALD F. APPOLONI, SR., ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether early retirement payments made to tenured public school teachers, who gave up tenure and other rights upon resigning from their positions, were "wages" subject to Federal Insurance Contributions Act taxes.

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In the Supreme Court of the United States

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DONALD F. APPOLONI, SR., ET AL., PETITIONERS

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UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-34a) is reported at 450 F.3d 185. The opinions of the district courts (Pet. App. 35a-60a, 61a-75a) are reported at 328 F. Supp.2d 754 and 333 F. Supp. 2d 624, respectively.

JURISDICTION

The judgment of the court of appeals was entered on June 7, 2006. The petition for a writ of certiorari was filed on September 5, 2006. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Federal Insurance Contributions Act (FICA) tax (see 26 U.S.C. 3101-3128) funds Social Security and Medicare benefits. FICA taxes are imposed on both employees and employers, and both elements of the tax

are imposed on all "wages" received by an employee "with respect to employment." 26 U.S.C. 3101(a) and (b). For purposes of the FICA tax, the term "wages" is defined, with exceptions not relevant here, to mean "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash." 26 U.S.C. 3121(a) (2000 & Supp. III 2003). The term "employment" is defined, again with exceptions not relevant here, as "any service, of whatever nature, performed * * * by an employee for the person employing him." 26 U.S.C. 3121(b).

2. The instant case presents the question whether early retirement payments made to tenured teachers, who voluntarily relinquished their employment rights upon receipt of the payments, were "wages" within the meaning of 26 U.S.C. 3121(a) (2000 & Supp. III 2003). The court of appeals' decision resolved two separate lawsuits, one brought in the Western District of Michigan and the other in the Eastern District of Michigan, in which the district courts had issued conflicting rulings on that question.

Each of the named petitioners is a former tenured public school teacher in Michigan who had accepted the benefits of a voluntary early retirement program offered by his or her school district. See Pet. App. 2a. Each named petitioner had attained a certain level of seniority with satisfactory performance and, accordingly, had been awarded tenure under the Michigan Teachers' Tenure Act, which provides that public school teachers are automatically awarded tenure after successfully completing a probationary employment period. See *id.* at 3a-5a; Mich. Comp. Laws Ann. §§ 38.71 *et seq.* (West 2005). "As tenured teachers, [petitioners] were entitled to continued employment with their respective school

districts absent 'reasonable and just cause' and subject to the procedural protections set forth in the Tenure Act." Pet. App. 3a; see Mich. Comp. Laws Ann. §§ 38.91, 38.101 (West 2005).

Because more experienced teachers command larger salaries than do new employees, petitioners' school districts offered severance plans to induce senior teachers to separate from employment in exchange for a fixed sum payable in regular installments. Pet. App. 36a. Although differing in their details, each of the programs imposed certain participation requirements, including minimum years of service, and each required the employee to agree to relinquish tenure rights and waive all employment-related claims. *Id.* at 3a-5a, 38a-43a, 62a-63a. In accordance with the requirements of those programs, petitioners voluntarily severed their employment, relinquished their tenure rights, and began to receive payments under their respective plans. See *id.* at 3a-5a. When their respective school districts withheld FICA taxes from the payments, petitioners filed unsuccessful administrative refund claims with the Internal Revenue Service (IRS), followed by the instant refund suits. See *id.* at 4a, 5a.

3. On cross-motions for summary judgment in each case, the two district courts reached inconsistent conclusions.

a. The United States District Court for the Eastern District of Michigan held that the payments in question were not FICA "wages." Pet. App. 35a-60a. In the district court's view, the payments "were not for services, past, present or future. Rather, they were made in exchange for the employees' relinquishment of the right to exchange services for wages in the future." *Id.* at 54a. In reaching that conclusion, the court relied substan-

tially (see *id.* at 45a-49a, 55a) on the Eighth Circuit's decision in *North Dakota State University* v. *United States*, 255 F.3d 599 (2001) (*North Dakota*), which had held that payments made to tenured university professors under an early retirement program that required the professors to relinquish tenure rights were not "wages" subject to FICA tax.

b. By contrast, the United States District Court for the Western District of Michigan held that the payments at issue were "wages" subject to FICA tax. Pet. App. 61a-75a. That court stated that it would "determin[e] the issue of whether the [Employee Severance Plan] payments were wages by answering the following questions: (1) Did [petitioners] receive the payments because of the employment relationship with the [School] District?; and (2) Were [petitioners'] tenure rights a benefit [petitioners] earned through prior service to the District?" *Id.* at 72a. The district court answered both those questions in the affirmative and accordingly ruled in favor of the government. See *id.* at 72a-75a.

4. The court of appeals consolidated the two cases and held that the payments received by petitioners were FICA "wages." Pet. App. 1a-34a. The court recognized that, under the precedents of this Court and of the Sixth Circuit, the term "wages" in 26 U.S.C. 3121(a) (2000 & Supp. III 2003) is to be given a broad construction. Pet. App. 7a-9a. The court further held that "the eligibility requirements for qualifying for a payment—that a teacher served a minimum number of years—indicate the payments were for services performed" and therefore "constitute[d] FICA wages." *Id.* at 10a; see *id.* at 10a-12a.

The court of appeals rejected petitioners' contention that the payments at issue in this case were not FICA

"wages" because they had been made in exchange for petitioners' relinquishment of tenure rights. Pet. App. 12a-14a. The court observed that "just because a teacher relinquishes a right when accepting early retirement does not convert what would be FICA wages into something else." *Id.* at 12a. The court found this case to be materially indistinguishable from prior decisions holding that "severance payments for the relinquishment of rights in the course of an employment relationship are FICA wages." *Id.* at 13a. The court explained that, "[i]n this case, the school district's motivation was not to buy tenure rights—the motivation was to induce those teachers at the highest pay scales to retire early. Relinquishment of tenure rights was simply a necessary and incidental part of accepting the buyout." *Id.* at 14a.

The court of appeals also "agree[d] with the government's position that the most applicable [IRS] revenue ruling indicates the severance payments [at issue in this case] are FICA 'wages.'" Pet. App. 14a; see *id.* at 14a-16a. The court recognized that the Eighth Circuit in *North Dakota* had relied on Revenue Ruling 58-301, 1958-1 C.B. 23. See Pet. App. 15a. The court concluded, however, that Revenue Ruling 75-44, 1975-1 C.B. 15, was the Revenue Ruling most analogous to the situation presented here. The court explained that Revenue Ruling 75-44 had involved an employee's relinquishment of employment rights that the employee had previously acquired through length of service to the employer, whereas the employee in Revenue Ruling 58-301 had surrendered contract rights conferred at the outset of the employment relationship. Pet. App. 15a-16a.[1]

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[1] During the pendency of this litigation, the IRS issued Revenue Ruling 2004-110, 2004-2 C.B. 960. That Ruling addressed, inter alia, the

The court of appeals further acknowledged that its "holding, and [its] reliance on Revenue Ruling 75-44, differs from what the Eighth Circuit held in *North Dakota*." Pet. App. 16a. The court stated, however, that it found the reasoning of the Court of Federal Claims (CFC) in *CSX Corp.* v. *United States*, 52 Fed. Cl. 208 (2002), supplemented, 71 Fed. Cl. 630 (2006), appeal pending, No. 07-5003 (Fed. Cir. filed Oct. 4, 2006), No. 07-5007 (Fed. Cir. filed Oct. 18, 2006), to be more persuasive than that of the Eighth Circuit in *North Dakota*. Pet. App. 16a-17a. The court also noted that the tenure rights at issue in *North Dakota* were "factually distinguishable" from those involved here. *Id.* at 16a n.5. The court explained:

> In *North Dakota*, even though the monetary amount of any individual[']s rights was determined, at least partially, by length of service, the tenure rights in

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question "[w]hether an amount paid to an employee as consideration for the cancellation of an employment contract and relinquishment of contract rights is * * * wages for purposes of [FICA]." *Ibid.* The IRS concluded that such a "payment provided by the employer to the employee is wages for purposes of FICA." *Id.* at 961. The IRS further stated that Revenue Ruling 58-301's contrary conclusion was erroneous, *ibid.*, and that Revenue Ruling 58-301 was "modified and superseded" with respect to its analysis of FICA taxation, *id.* at 962.

In Revenue Ruling 2004-110, the IRS stated that it "will not apply the position adopted in this ruling to any payment that an employer made to an employee or former employee before January 12, 2005, provided that the payment is made under facts and circumstances that are substantially the same as in * * * Rev. Rul. 58-301." 2004-2 C.B. at 962. In the instant case, the court of appeals stated that, "[b]ecause a large portion of the payments to which [petitioners] were entitled under the buyout agreements were made prior to this date, and because * * * Revenue Ruling 75-44 is analogous to the facts of this case, [the court would] decline to rely on Revenue Ruling 2004-110 in making [its] decision." Pet. App. 15a n.4.

> *North Dakota* were created by a single contract made at the onset of the tenure relationship. *North Dakota*, 255 F.3d at 601. Tenure, moreover, was not automatic; the North Dakota Board of Higher Education considered several factors in making tenure determinations, "including scholarship in teaching, contribution to a discipline or profession through research, other scholarly or professional activities, and service to the institution and society." *Id.*

Ibid.

Judge Griffin dissented in part. Pet. App. 19a-34a. Except with respect to the claim of one plaintiff who is not a petitioner in this Court, Judge Griffin would have held that the payments at issue were not FICA "wages." See *id.* at 19a.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court. Although there is significant tension between the decision below and the ruling of the Eighth Circuit in *North Dakota*, the two cases are factually distinguishable. In addition, the IRS has recently issued a Revenue Ruling that clarifies the agency's position concerning the application of 26 U.S.C. 3121(a) (2000 & Supp. III 2003) to severance payments by confirming that an amount paid to an employee as consideration for the cancellation of an employment contract and relinquishment of contract rights is FICA "wages." That Revenue Ruling modifies and supersedes, and thus essentially revokes, the 1958 Revenue Ruling on which the Eighth Circuit substantially relied, and it may ultimately eliminate the current tension between the Sixth and Eighth Circuit ap-

proaches. This Court's review therefore is not warranted at the present time.

1. The decision of the court of appeals is correct.

a. In order to accomplish the important remedial purposes of the Social Security Act, Congress imposed FICA taxes on a broad range of employer-furnished remuneration. See H.R. Rep. No. 615, 74th Cong., 1st Sess. 3 (1935); *Helvering* v. *Davis*, 301 U.S. 619, 641 (1937); *Temple Univ.* v. *United States*, 769 F.2d 126, 130 (3d Cir. 1985), cert. denied, 476 U.S. 1182 (1986). As the Court explained in *United States* v. *Silk*, 331 U.S. 704, 712 (1947), a restrictive interpretation of the terms "employment" and "employee," as those terms are used in the definition of FICA "wages," "would only make for a continuance, to a considerable degree, of the difficulties for which [Social Security] was devised and would invite adroit schemes by some employers and employees to avoid the immediate burdens at the expense of the benefits sought by the legislation."

Consistent with the expansive statutory language and the remedial purpose of the Social Security Act, this Court has construed the term "wages" broadly. In *Social Security Board* v. *Nierotko*, 327 U.S. 358 (1946), the Court addressed the question whether back pay, paid to an employee who had been wrongfully discharged and then reinstated, represented "wages" for Social Security purposes, even though the worker had not earned the back pay through the performance of actual services. The Court explained:

> The very words "any service . . . performed . . . for his employer," with the purpose of the Social Security Act in mind, import breadth of coverage. They admonish us against holding that "service" can be only productive activity. *We think that "service" as*

> *used by Congress in this definitive phrase means not only work actually done but the entire employer-employee relationship for which compensation is paid to the employee.*

327 U.S. at 365-366 (emphasis added).[2]

b. Applying that approach, the court of appeals correctly concluded that the payments at issue in this case were FICA "wages." The court recognized that "where a payment arises out of the employment relationship, and is conditioned on a minimum number of years of service, such a payment constitutes FICA wages." Pet. App. 10a. The court explained that the payments at issue here were FICA "wages" because those payments "arose out of the employment relationship, and were conditioned on a minimum number of years of service." *Id.* at 11a-12a.

The court of appeals correctly rejected petitioners' contention that the severance payments here were not FICA "wages" because they represented compensation for the relinquishment of tenure rights. Pet. App. 11a-14a. The court acknowledged that, because the length of service required to establish eligibility for the buyout program exceeded the number of years required for tenure under Michigan law, petitioners "necessarily had to have tenure to be eligible for the buyout." *Id.* at 11a.

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[2] Although the Court in *Nierotko* held that the case was governed by the Social Security Act of 1935 rather than the Social Security Act amendments of 1939, see 327 U.S. at 360, the Court specifically disavowed any suggestion that the differences between the two enactments were significant with respect to the issues the Court considered, see *id.* at 360 n.5. And because the relevant statutory definitions have remained essentially unchanged, the *Nierotko* Court's interpretation of the definitions of FICA "wages" and other pertinent terms is directly applicable here.

The court recognized, however, that "longevity—not tenure—was the key factor for determining eligibility because these early retirement payments were offered to encourage teachers at a high pay rate to retire." *Ibid.* "Relinquishment of tenure rights was simply a necessary and incidental part of accepting the buyout." *Id.* at 14a. Under those circumstances, the court of appeals correctly declined "to differentiate the relinquishment of tenure rights from the relinquishment of other benefits earned during the course of employment, like the right to bring suit, or rights associated with seniority." *Ibid.*

Indeed, the payments at issue here would properly be treated as FICA "wages" even if they were regarded as payments made to induce the relinquishment of tenure rights. Tenure under Michigan law is simply a right, earned through service to the employer over a specified amount of time, to protection against being fired without cause. For purposes of 26 U.S.C. 3121(a)'s definition of "wages," the prerogatives associated with petitioners' tenure were no different from seniority rights or other security in employment. Severance payments made to induce the relinquishment of such employment-related rights are properly treated as FICA "wages." See, *e.g.*, *Abrahamsen* v. *United States*, 228 F.3d 1360, 1364-1365 (Fed. Cir. 2000), cert. denied, 532 U.S. 957 (2001); *Associated Elec. Coop., Inc.* v. *United States*, 226 F.3d 1322, 1327 (Fed. Cir. 2000) (payments under "early out" plan to employees who gave up rights to security in employment that had been earned through service "were intimately related to and arose from the employer-employee relationship, and thus were [FICA] 'wages'").

2. Petitioners contend (Pet. 10) that the Sixth Circuit's decision in this case squarely conflicts with the

Eighth Circuit's ruling in *North Dakota*, and that this Court should grant review to resolve the conflict. The Sixth Circuit recognized that its "holding, and [its] reliance on Revenue Ruling 75-44, differs from what the Eighth Circuit held in *North Dakota*." Pet. App. 16a. For two reasons, however, the tension between the decisions does not warrant resolution by this Court at the present time.

a. The plaintiffs who prevailed in *North Dakota* were tenured university professors. See 255 F.3d at 605-607. In concluding that the buyout payments at issue in that case were not FICA "wages," the Eighth Circuit attached significance to the criteria used to grant tenure at that institution and the factors considered in determining the amount of an individual professor's buyout payment. The court observed that, "[a]lthough past service plays a part in the decision to grant tenure, tenure is much more than a recognition for past services. Importantly, tenure is not automatic upon completing service for a specified time period, which is a hallmark of ordinary seniority rights." *Id.* at 605. The court explained that the criteria used to award tenure also included "scholarship, research, and service to the university and society." *Id.* at 606.

Based on those considerations, the court in *North Dakota* found that the university's decision to grant tenure had the practical effect of creating a new contractual relationship between the professor and the school. See 255 F.3d at 606. The court reasoned that, "contrary to the government's argument that tenure rights are earned by past service to the university, tenure rights are established at the outset of the tenured relationship." *Ibid.* The court relied on that analysis in concluding that Revenue Ruling 58-301, rather than Revenue

Ruling 75-44, was the most analogous agency precedent. See *id.* at 605-607.

In the instant case, by contrast, the Sixth Circuit attached significance to the fact that eligibility for the relevant buyout programs was based solely on length of service to the school district. The court stated that "the eligibility requirements for qualifying for a payment—that a teacher served a minimum number of years—indicate the payments were for services performed rather than for the relinquishment of tenure rights." Pet. App. 10a. The court accordingly relied on prior decisions holding "that where a payment arises out of the employment relationship, and is conditioned on a minimum number of years of service, such a payment constitutes FICA wages." *Ibid.* And in concluding (unlike the court in *North Dakota*) that Revenue Ruling 75-44 involved a more analogous set of facts than Revenue Ruling 58-301, the Sixth Circuit emphasized that the employee rights surrendered under the buyout programs had been earned automatically through completion of a probationary period and thus were acquired through length of service to the relevant school districts. See *id.* at 12a, 15a-17a.

While expressing disagreement with the reasoning of the Eighth Circuit in *North Dakota*, Pet. App. 16a, the Sixth Circuit also noted that "*North Dakota* is factually distinguishable," *id.* at 16a n.5. The court explained that "the tenure rights in *North Dakota* were created by a single contract made at the onset of the tenure relationship," and that tenure for North Dakota professors was not automatic after a specified period of service but depended on a variety of factors. *Ibid.* Although the government does not believe that the correct application of 26 U.S.C. 3121(a) turns on those factual distinctions (see

p. 13, *infra*), the Sixth and Eighth Circuits each attached significant weight to facts that were not present in the other case. For that reason, no square conflict between the two decisions exists.

b. In Revenue Ruling 2004-110, 2004-2 C.B. 960 (see note 1, *supra*), the IRS recently addressed the question "[w]hether an amount paid to an employee as consideration for the cancellation of an employment contract and relinquishment of contract rights is * * * wages for purposes of [FICA]." The IRS concluded that such a "payment provided by the employer to the employee is wages for purposes of FICA." *Id.* at 961. The IRS further stated that Revenue Ruling 58-301's contrary conclusion was erroneous, *ibid.*, and that Revenue Ruling 58-301 was "modified and superseded" with respect to its analysis of FICA taxation, *id.* at 962. Under the analysis set forth in Revenue Ruling 2004-110, the severance payments at issue in both the instant case and *North Dakota* would be treated as FICA wages, notwithstanding the factual differences between the two cases.

If given the opportunity to reexamine the holding in *North Dakota* in light of Revenue Ruling 2004-110, the Eighth Circuit may hold that severance payments of the sort at issue in that case are properly treated as FICA "wages." That is particularly so in light of the fact that the Eighth Circuit relied substantially on Revenue Ruling 58-301, see 255 F.3d at 603-604, 607, whose analysis with respect to FICA was expressly disavowed in Revenue Ruling 2004-110. Thus, even if the Sixth Circuit's decision in this case were squarely in conflict with the ruling in *North Dakota*, review by this Court would be premature until the Eighth Circuit has been given an

opportunity to apply the IRS's current guidance on the question presented here.

In Revenue Ruling 2004-110, the IRS stated that it "will not apply the position adopted in this ruling to any payment that an employer made to an employee or former employee before January 12, 2005, provided that the payment is made under facts and circumstances that are *substantially the same* as in * * * Rev. Rule 58-301." 2004-2 C.B. at 962 (emphasis added). The italicized language reflects the IRS's recognition that employees whose circumstances are materially indistinguishable from the facts considered in Revenue Ruling 58-301 may have organized their affairs in reasonable reliance on the analysis set forth in that Ruling. Because the employee in Revenue Ruling 58-301 relinquished contractual rights that had been acquired at the outset of the employment relationship under a contract employing him for a limited term, see Pet. App. 16a; 1958-1 C.B. at 23, the circumstances presented here (and, we submit, in *North Dakota* as well) are not "substantially the same" as those in Revenue Ruling 58-301. Revenue Ruling 2004-110 therefore applies to the instant case, even though many of the buyout payments at issue here were made before that Ruling was issued.[3]

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[3] Petitioner errs in contending (Pet. 20-21 & n.7) that Revenue Ruling 2004-110 is not entitled to deference. Although revenue rulings are not issued pursuant to notice and comment procedures, the absence of such formalities in the rulemaking process does not preclude *Chevron* deference when, as here, Congress granted the agency the power to make rules with the "force of law" and "the agency interpretation claiming deference was promulgated in the exercise of that authority." *United States* v. *Mead Corp.*, 533 U.S. 218, 226-227, 230-231 (2001); see *Barnhart* v. *Walton*, 535 U.S. 212, 221-222 (2002).

Revenue rulings satisfy that test. Contrary to petitioners' assertion (Pet. 20 n.7), the IRS promulgates revenue rulings pursuant to its

The Sixth Circuit, however, "decline[d] to rely on Revenue Ruling 2004-110 in making [its] decision," partly on the ground that "a large portion of the payments to which [petitioners] were entitled under the buyout agreements were made prior to" January 12, 2005. Pet. App. 15a n.4. If this Court's resolution of the question presented here ultimately becomes necessary, it would be preferable for the Court to address that issue in a case in which no possible uncertainty exists as to the applicability of Revenue Ruling 2004-110.

3. We agree with petitioners (see Pet. 21-23) that this case and *North Dakota* raise questions of substantial and recurring importance. When confronted with uncertain revenue or declining employment needs, educational institutions frequently institute voluntary early

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statutory authority to "prescribe all needful rules and regulations for the enforcement of" the Code. 26 U.S.C. 7805(a); see Treas. Order 111-2, 1981-1 C.B. 698, 699. Revenue rulings are formal interpretive rulings involving "substantive tax law," 26 C.F.R. 601.601(d)(2)(v)(a). They are "issued only by the [IRS] National Office" and are published in the Internal Revenue Bulletin as the agency's "official interpretation" to guide taxpayers and IRS employees alike. 26 C.F.R. 601.601(d)(2)(i)(a). Revenue rulings have legal force and effect in that they constitute "precedents to be used in the disposition of other cases" that "may be cited and relied upon for that purpose." 26 C.F.R. 601.601(d)(2)(v)(d). And a taxpayer's disregard of applicable revenue rulings can result in the imposition of penalties. 26 U.S.C. 6662; 26 C.F.R. 1.6662-3(b)(2). Thus, revenue rulings have the "force of law" within the meaning of *Mead*, 533 U.S. at 227, and *Chevron* deference is appropriate.

In any event, Revenue Ruling 2004-110 is not based solely on a construction of the statutory text, but also reflects the agency's considered interpretation of its own regulations and prior rulings. See 2004-2 C.B. at 961-962. Accordingly, the ruling is also entitled to deference under the principles of *Bowles* v. *Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945). See *United States* v. *Cleveland Indians Baseball Co.*, 532 U.S. 200, 220 (2001).

retirement programs like the ones at issue here, under which tenured employees receive lump-sum payments in exchange for relinquishing their rights in continued employment. Litigation concerning the applicability of 26 U.S.C. 3121(a) (2000 & Supp. III 2003) to such payments is currently pending before the Third Circuit, see *University of Pittsburgh* v. *United States* (No. 06-1276), and in the District of Utah, see *University of Utah* v. *United States* (Civ. No. 2:06-cv-00595 DAK). A similar dispute involving railroad employees was decided by the CFC in *CSX Corp.*, 52 Fed. Cl. at 219-221. See Pet. App. 16a-17a (agreeing with the CFC's analysis). The question presented in this case therefore may ultimately warrant resolution by this Court. For the reasons stated above, however, the Court's review would be premature at the present time.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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IN THE

Supreme Court of the United States

DONALD F. APPOLONI, SR.; RUSSELL C. BERGEMANN; CHARLES BRYCE ENGLE, as personal representative of the estate of Sandra Engle; PHYLLIS F. KLENDER; and ROGER J. PETRI,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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PETITIONERS' REPLY BRIEF

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IN THE

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DONALD F. APPOLONI, SR.; RUSSELL C. BERGEMANN; CHARLES BRYCE ENGLE, as personal representative of the estate of Sandra Engle; PHYLLIS F. KLENDER; and ROGER J. PETRI,

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PETITIONERS' REPLY BRIEF

ARGUMENT

1. In its Brief in Opposition, the Government agrees with petitioners on the following points:

- This case "raise[s] questions of substantial and recurring importance." Br. in Opp. at 15.
- The Sixth Circuit's resolution of these important questions is in "significant tension" with the Eighth Circuit's resolution of the same issues in *North Dakota State University v. United States*, 255 F.3d 599 (8th Cir. 2001). Br. in Opp. at 7.

- While there are some differences in the facts upon which this case and the *North Dakota* case were resolved, "the correct application of 26 U.S.C. § 3121(a) [does not] turn[] on those factual distinctions." Br. in Opp. at 12.

Simply stated, then, the Government acknowledges that there is a conflict in the Circuits on the tax question of substantial and recurring importance squarely presented by this petition. The Government nonetheless opposes granting the petition on the ground that to do so would be "premature." Br. in Opp. at 16. It offers two reasons why the Court should wait for another occasion to address the question presented here that has divided the lower courts and that continues to spawn litigation. The first is based on factual differences in how tenure is granted in the school and university settings, *id.* at 11-13, and the second relies on Revenue Ruling 2004-110, 2004-2 C.B. 960, in which the Internal Revenue Service ("IRS"), while this matter was pending on appeal, addressed the question presented by this and the *North Dakota* cases. Br. in Opp. at 13-15. Neither presents a reason for delaying resolution by this Court of the question raised by this petition.

a. The issue presented is whether payments made to the petitioner school teachers to induce them to surrender their statutory entitlement to continued employment constitute "wages," as that term is defined in 26 U.S.C. § 3121(a). Notwithstanding the Government's acknowledgment that it "does not believe that the correct application of 26 U.S.C. 3121(a) turns on [the] factual distinctions" between petitioners' tenure rights under the Michigan Teachers' Tenure Act and the contractual tenure rights enjoyed by the university professors in *North Dakota*, Br. in Opp. at 12, the Government relies on these factual differences to insist that "no square conflict . . . exists" between the Sixth and Eighth Circuits. *Id.* at 13.

According to the Government, the grant of tenure to Michigan school teachers is "automatic," *id.* at 12, while the grant of tenure for the *North Dakota* university professors was an act of employer judgment. That is a false distinction. Neither Michigan public school teachers nor North Dakota university professors are granted tenure "automatic[ally] after a specified period of service." *Id.* To be sure, the factors upon which the tenure determination is based are undoubtedly different in the two settings, and the percentage of candidates to whom tenure is granted is undoubtedly much higher for K-12 teachers than for university professors. Nonetheless, in one case as in the other, the award of tenure represents the employer's judgment that the teacher or professor merits a lifetime appointment. *See Amato v. Oxford Area Cmty. Sch. Dist. No. 7*, 266 N.W.2d 445, 446 (Mich. 1978) (only a teacher "who *satisfactorily* completes probation is entitled to tenure") (emphasis added). That a school district may not continue to employ a teacher beyond the four-year probationary period without tenure being granted, Mich. Comp. Laws § 38.82, hardly means that tenure is "automatic"—as any teacher who has been "nonrenewed" at the end of the probationary period can attest. *See, e.g., Kentwood Pub. Schs. v. Kent County Educ. Ass'n*, 520 N.W.2d 682 (Mich. Ct. App. 1994).

The essential point for purposes of the question presented here is the same in both cases. Like the university professors in *North Dakota* for whom the grant of tenure resulted in a new legal "relationship" with their employer—in which the "initial at-will relationship during the probationary period" gave way to the "subsequent tenured relationship," 255 F.3d at 606—the grant of tenure to Michigan teachers results, by operation of state law, in a new and qualitatively different legal relationship between the teacher and his or her employing school district. *Compare* Mich. Comp. Laws §§ 38.81-38.84 *with id.*, §§ 38.91-38.121. Central to that new "relationship"—for the Michigan teachers like the *North*

Dakota professors—is the legal right to lifetime employment (absent "just cause" for dismissal). *See id.*, § 38.101. That legally enforceable right to continued employment is what both these petitioners and the *North Dakota* university professors gave up in exchange for the buyout payments from their employers. In that regard there is no material difference in the tenure right surrendered by the university professors in *North Dakota* and the tenure right surrendered by the petitioner teachers in this case. That is why, as the Government properly recognizes, the question presented here does not turn on any factual distinction in how tenure is granted in the school and university settings.

b. The Government also argues that "it would be preferable for the Court to address [this] issue in a case in which no possible uncertainty exists as to the applicability of Revenue Ruling 2004-110." Br. in Opp. at 15. In fact, there is no such uncertainty in this case. Because some of the buyout payments at issue were not due to be made until after January 12, 2005,[1] Revenue Ruling 2004-110 clearly would have to be addressed in determining whether those payments were subject to FICA taxation—whether or not the facts and circumstances of petitioners' payments were deemed to be "substantially the same" as in the abrogated Revenue Ruling 58-301, 1958-1 C.B. 23. *See* Br. in Opp. at 14. Both parties in the court below agreed that Revenue Ruling 2004-110 purported to apply to some or all of the payments at issue, and accordingly the effect of that ruling was fully briefed by both parties in the Sixth Circuit. Even though that court—given its resolution of the case against petitioners on other

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[1] While petitioner Petri had received all of the payments that were due him prior to January 2005, the monthly payments to which petitioners Appoloni, Bergemann, Engle, and Klender were entitled under their buyout agreements were to continue until September 2006. *See Appoloni* 6th Cir. Appendix at 135-36; *Klender* 6th Cir. Appendix at 136.

grounds—did not find it necessary to address Revenue Ruling 2004-110, there is no question that it would be squarely before this Court, should review be granted.[2]

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[2] It is not necessary, for purposes of determining whether to grant review, to decide whether the Government is right in contending that IRS revenue rulings are entitled to deference under the standard of *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). *See* Br. in Opp. at 14-15 n.3. It bears noting, however, that while this Court has not decided the issue, *see United States v. Cleveland Indians Baseball Co.*, 532 U.S. 200, 220 (2001), those courts that have recently addressed the degree of deference to which IRS revenue rulings are entitled—both before and after this Court's decision in *United States v. Mead Corp.*, 533 U.S. 218 (2001)—have held that IRS revenue rulings are *not* entitled to *Chevron* deference, but only to the lesser degree of respect that is appropriate under *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944). That is because, as the Sixth Circuit has explained, "[w]hen promulgating revenue rulings, the IRS does not invoke its authority to make rules with the force of law." *Aeroquip-Vickers, Inc. v. Commissioner*, 347 F.3d 173, 181 (6th Cir. 2003) (citing Rev. Proc. 89-14, 1989-1 C.B. 814). *See also O'Shaughnessy v. Commissioner*, 332 F.3d 1125, 1129 (8th Cir. 2003); *Omohundro v. United States*, 300 F.3d 1065, 1067-68 (9th Cir. 2002); *Del Commercial Props., Inc. v. Commissioner*, 251 F.3d 210, 214 (D.C. Cir. 2001); *Dominion Res., Inc. v. United States*, 219 F.3d 359, 366 (4th Cir. 2000); *First Chicago NBD Corp. v. Commissioner*, 135 F.3d 457, 458-59 (7th Cir. 1998). Indeed, the Tax Court treats revenue rulings as "merely the contention of one of the parties to the litigation." *Estate of Smead v. Commissioner*, 78 T.C. 43, 47 n.5 (1982).

The Government's further assertion that Revenue Ruling 2004-110 is entitled to deference under *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410 (1945), as "the agency's considered interpretation of its own regulations and prior rulings," Br. in Opp. at 15 n.3, is even farther off the mark. In issuing Revenue Ruling 2004-110 the IRS did not "interpret" its prior ruling in Revenue Ruling 58-301—it *abrogated* that interpretation of nearly 50 years' standing based on the IRS' new-found view that the earlier ruling had "erred in [its] analysis by failing to apply the Code and regulations appropriately." 2004-2 C.B. at 961. Revenue Ruling 2004-110 most assuredly does *not* "simply reflect the agency's longstanding interpretation of its own regulations." *Cleveland Indians*, 532 U.S. at 220. And, in any event, Revenue Ruling 2004-110 is so clearly contrary to the language of the statute and this Court's cases, *see* Petition at 21 & n.8,

2. The Government's brief also makes evident that, on the merits, the Sixth Circuit's interpretation of § 3121(a) is indefensible.

The most striking aspect of the Government's defense of the Sixth Circuit's decision, Br. in Opp. at 8-10, is the total absence of any attempt to reconcile that interpretation with the statutory language of 26 U.S.C. § 3121(a) and (b). Indeed, after brief mention in the opening paragraph of the Statement, the statutory language disappears from view. Instead, in apparent recognition of the difficulty in bringing payments made in exchange for surrender of a legally enforceable right to continued future employment within the statutory definition of "employment" as "service . . . performed" for the employer, 26 U.S.C. § 3121(b), the Government argues that the payments in question were not made in exchange for the surrender of such a right, but rather that "[r]elinquishment of tenure rights was simply a necessary and incidental part of accepting the buyout." Br. in Opp. at 10 (quoting Pet. App. 14a).

That formulation simply begs the question of what, then, was being "bought out," if not the teachers' legal rights, under the Michigan Teachers' Tenure Act, to continued future employment. The Government has no answer to that question. The payments cannot, as we pointed out in the Petition, fairly be characterized as compensation for the 10 or 20 years (depending on the particular buyout plan) of service to the school district that was the prerequisite for participation in the plan, because the petitioners' similarly situated colleagues—with equal years of service—who declined to accept the buyouts did not receive any such payments. Clearly, therefore, the payments were made in exchange for something more—not just satisfaction of the plan's service

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that it should not be followed even if the *Chevron* or *Bowles* standard were applicable.

prerequisite, but agreement to give up the legally enforceable right to continued future employment. *See* Petition at 16.[3]

There may well be, as the Government suggests, line-drawing issues at the margins between payments made in exchange for the surrender of statutory or contractual rights to continued future employment and payments for the relinquishment of seniority rights—which the IRS has treated as "wages." *See* Rev. Rul. 75-44, 1975-1 C.B. 15.[4] While the necessity of considering whether, and if so how, to draw such lines may well be reason enough for the Court to grant plenary review in this case rather than summarily reversing the Sixth Circuit, it does not change the fact that the question actually presented on the facts of this case is straightforwardly and properly resolved against the Government's

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[3] The assertion of the Government and the Sixth Circuit that in this case "longevity . . . was the key factor for determining eligibility," Br. in Opp. at 10 (quoting Pet. App. 11a), is true only to the extent that what is meant is eligibility for participation in the buyout plan. It is incorrect, however, to say that longevity was the "key factor" that determined who received a payment—which is the point that is relevant to determining what the payment was made in exchange for. Nor does this point provide any basis for distinguishing this case from *North Dakota*. There, as here, eligibility to participate in the plan turned on longevity (measured, in the *North Dakota* case, by a "rule of 70," *see* 255 F.3d at 601), but in both cases payments were made to employees only based upon their agreement to surrender their legally enforceable rights to continued employment. In neither case were any payments made to employees who merely met the longevity requirement.

[4] The fundamental distinction is clear enough, however. Seniority rights, which by their nature are earned through longevity in employment and nothing more, typically entitle the employee to higher pay and to preferences in job assignments, scheduling, vacation time, protection against layoffs, and the like, vis-à-vis fellow employees. Waiving such seniority-related preferences—which give the employee certain job benefits *as long as his or her employment lasts*—cannot be equated with accepting the buyout of a legally enforceable right to continued future employment.

position on the basis of the statutory language and in full accord with this Court's existing precedent.

3. The sum of the matter is that the Government's plea for the Court to leave the law on the important tax question presented by the petition in its present state of disarray is unsound and unjustified. Both employers and employees need certainty and uniformity in the interpretation of the tax laws with respect to an issue that arises so commonly and that involves substantial amounts of money. The instant case presents an appropriate vehicle for resolution of the question whether incentive payments made in exchange for surrender of a legally enforceable right to continued employment constitute "wages" on which FICA taxes are due, and the Court should not leave employer and employee taxpayers in the present state of uncertainty while this issue continues to divide the lower courts.

CONCLUSION

The Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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